The policy environment shaping public expenditures and the composition of social expenditures in the European Union*

(Revised version)

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Introduction

Our study aims to review the environment shaping public expenditures in general and social expenditures in particular in the new member-states (NMS)\(^1\) of the European Union (EU) as compared with the older members (EU-15). The study consists of two distinct, but interrelated parts. The first covers certain general trends characterising social expenditures in the EU-10 in comparison with the EU-15: it discusses factors affecting recent developments in these expenditures, their comparative size, as well as statistical problems related to the international comparison of these items. The second part addresses specific issues concerning social expenditures and other aspects of public policy that may directly or indirectly affect children.

The motivation of the study is to provide background information and draw some lessons based on experiences of EU-countries, as well as indicate the kinds of problems/challenges that candidate (and other prospective member-) countries of the EU may have to face in the area of managing social – especially children-related – public expenditures.

1. General environment of, and trends in, social expenditures in the EU

In the following we review developments in public expenditures related to social goals in the NMS as compared to the EU-15. As a background, we briefly touch upon some general issues related to the size of government expenditures, the management of public finances and present indications regarding the importance of social expenditures in Europe. This is followed by an overview of the recent macroeconomic policy environment influencing public expenditures in the European Union. Before turning to international comparisons of social expenses, we discuss methodological problems of comparing the volume of social outlays among countries at different levels of economic development, whose structure of domestic prices may differ significantly. In the final section we present comparisons of volumes and shares of overall social expenditures within the EU and touch upon some implications of these comparisons.

1.1. Public expenditures and social transfers in EU-countries: some preliminary observations

As a result of recent enlargements of the EU, the dispersion in per capita real GDP levels significantly increased within the Union. Therefore, it is natural to depart from the empirical relationship between the level of development and the size of government expenditures in the enlarged EU. As shown by Figure 1.1, which depicts the share of total public spending in GDP as against per capita real GDP in 2007, there is a clear association: governments of rich countries generally spend more, while those of relatively poor member-states spend less in fraction of GDP.\(^2\) The relationship, however, is rather loose; several countries do not fit into the overall pattern. (E.g. Hungary, at a similar level of economic development as the Baltic countries and Slovakia, has government spending roughly 15 percentage points higher, while in Spain the share of government spending is about 10% lower than in Italy, whose per capita GDP is close to that of Spain). Thus, large differences exist within the group of both less and more affluent countries behind the general tendency indicated by the cross-country trend.

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\(^1\) NMS-10: Czech Republic, Estonia, Cyprus, Latvia, Lithuania, Hungary, Malta, Poland, Slovenia, Slovakia. NMS-8: the above group less Cyprus and Malta. NMS-12: in addition to the above countries: Bulgaria and Romania. NMS(FS) (former socialist new members): NMS-8 plus Bulgaria and Romania. Our study focuses on the NMS-8.

\(^2\) In Figure 1.1 we disregard data for Ireland and Luxemburg, as these two countries are clearly outliers (both have much lower expenditures than what would correspond to their relative per capita GDP levels.).
The next question concerns the relation between public expenditures and economic growth. Here we focus on the period 2000-2007 and include all present member-states, irrespective of when they joined the EU. As indicated by Figure 1.2, there seems to be a negative relationship between GDP-growth and the size of the government, but this does not necessarily involve any kind of causality. The relationship is likely to be a simple reflection of convergence in per capita GDP levels among EU-members (involving higher economic growth of countries having lower levels of income) and the association observed in Figure 1.1 (lower levels of income are generally accompanied by lower expenditures). Therefore, it does not mean that smaller expenditures “explain” higher growth. While this possibility, as discussed later, cannot simply be ruled out, the line of causation can also be the opposite: a higher rate of economic growth may “automatically” reduce the relative size of the government.

Nevertheless, given the relationships indicated by Figures 1.1 and 1.2, some remarks are in order regarding the link between the level and change in economic development on the one hand, and the relative size of public expenditures on the other. A case in point is Sweden: it was among the countries with the highest growth rate in the more developed part of the EU, while it also had the highest ratio of public expenditures. In contrast, no similar examples can
be found in the group of the less developed members. The explanation for this contrast is likely to be related to *governance*, as discussed in Gray-Tracey-Varoudakis (2007):

„….the overall size of government influences economic growth rates (…) but this effect depends on the state of governance. Bigger governments can hinder growth in countries with weak governance, but this effect is nonlinear: below about one-third of GDP, the size of government is not correlated with growth, but once public spending exceeds 35 percent or so of GDP, increasing government size can have a negative impact on growth. Strong governance mitigates this negative effect, which is one reason that big governments do not necessarily reduce economic growth in some higher-income OECD countries.”

The association between *social* expenditures and relative income levels appears to be much closer than the one shown by Figure 1.1 (regarding total expenditures). The data presented in the next figure reflect the situation in 2006.

**Figure 1.3a. Social protection expenditures in percent of GDP and real per capita GDP (EU15=100) in the EU, 2006**

![Graph showing social protection expenditures in percent of GDP and real per capita GDP in the EU, 2006.](image)

Source: Eurostat

Just as in the case of total expenditures, there are differences within the group of the rich and relatively poor countries, but the variance is much milder among counties at levels of per capita GDP above the average of the EU-15. However, it is important to note already at this point that the comparison of social expenditures among nations at markedly different levels of economic development involves methodological difficulties – an issue to be elaborated later on. The problem is illustrated by Figure 1.3b which shows the share of government social transfers *in kind* (i.e., “government individual consumption”\(^3\)) in GDP at both *national* and *international* (average OECD) prices. We refer to shares in GDP at national prices as “nominal” and those at international prices as “real” shares. As shown by the figure, the positive relationship between the level of development and the relative size of social transfers in kind holds for “nominal shares”, but ceases to hold if differences in relative prices are corrected for. This phenomenon, as explained in detail in section 1.4 below, has to do with the fact that services, especially government services, are relatively cheap in poor countries. International comparisons of *real* expenditures can be meaningful only if these differences in relative prices are taken into account.

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\(^3\) See Annex 3 for definition of terms.
Turning to the impact and design of social spending, an important question concerns the extent to which these public expenditures achieve the task of assisting the relatively poor part of the population. Is there a difference in this respect between the EU and other OECD-countries? Figure 1.4, based on OECD (2007), offers a kind of answer to this question. 4

The pane on the right hand side shows gross transfers, while the one on the left indicates net transfers (i.e. gross flows adjusted for the effect of taxation) to the poorest quintile of the population. The two figures indicate that the majority of EU-countries are different from the rest of other members of the OECD, both regarding the gross and the net impact of social transfers to the poor. The inclusion of net transfers (the figure on the right hand side) calls attention to the fact that it may be too simplistic to observe only “apparent” (i.e. actual gross) transfers; attention has to be paid to the effect of the tax system as well. Both figures show that social transfers are targeted towards those in need to a larger extent in the EU than in the rest of the OECD (see the countries above and below the trend in the figures). It is reassuring that the new members included in the comparison are more similar to the more developed EU-members (with the possible exception of Poland) than to other OECD-countries.

4 For the underlying data and detailed explanation see Table A1. in Annex 1.
1.2. The effect of EU-regulations and requirements

While there are no explicit EU-regulations that directly affect the size and composition of public expenditures in member-countries, the combination of certain regulations and current influential views on fiscal policy do seem to influence governments’ policy decisions regarding fiscal expenditures.

As for EU-regulations, there are three types of requirements national governments have to observe. The first and most general one, applying to all member-countries, is to be found in Article 104 of the Treaty, declaring that “Member States shall avoid excessive government deficits”. This practically means the avoidance of deficits above 3 percent of GDP. If countries do not comply with this requirement, they are to face a so-called “excessive deficit procedure” (EDP), which exerts a kind of moral pressure, but for non-EMU (Economic and Monetary Union) countries it generally does not involve direct sanctions. The second layer of requirements concern countries wishing to join the EMU (or more popularly: the Euro-zone). For these countries the fiscal criteria of the Maastricht Treaty applies, one of which necessitates that public deficits do not surpass 3 percent of GDP. This criterion, to this date, has been binding. (The other fiscal criterion concerns the public debt-to-GDP ratio: this requires that its level be at 60%, or, at least, approach this level. The criterion of “approaching” has also been binding). Third, for members of the EMU the Stability and Growth Pact (SGP) applies, which calls for a balanced budget over the cycle; the violation of the 3 percent deficit limit, at least in principle, involves penalties (not effective to date).

These general regulations concern the balance of public finances. They, in themselves, have no direct implications for the size and composition of public expenditures. However, if taken together with the current mainstream views regarding the way deficits have to be cut, and the “received wisdom” that “small government” helps economic growth, then the requirements involve lower expenditures (relative to GDP) as well. In addition, the mainstream view prefers public expenditures on investment and education, rather than on social transfers. 5

All in all, there has been a strong institutional pressure on all EU-members to cut fiscal deficits and curtailing expenditures has been considered the appropriate way of performing this task. This does not imply that each of the new member countries followed these guidelines. Some countries/governments, in an attempt to increase electoral support, markedly departed from the explicit and implicit indications requirements discussed above. (Hungary, as to be shown in the following, is a case in point; while Slovakia’s example shows the merits of maintaining fiscal discipline.)

1.3. Recent developments in the balance and the size of the general government in the NMS

As an empirical background for discussing actual trends in social expenditures, this section reviews recent developments in fiscal balances and the relative size of overall public expenditures in the NMS region, as compared to the EU-15 average. 6

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5 For publications reflecting the mainstream view regarding the “appropriate” fiscal consolidation and the relationship between public finances and economic growth see e.g.: Alesina – Ardagna (1998), Ardagna (2004), Gray et. al. (2007), Von Hagen – Strauch (2001).
6 Here, and all through the paper, the terms „fiscal balance” and „public spending” etc. refer to the general government.
Figure 1.5. Net lending/borrowing of the general government: EU-15 average vs. NMS-12 in percent of GDP (2000-2007)

Source: AMECO-database

Figure 1.5 shows the evolution of the balance (in official statistical terms: net lending/borrowing) of the general government in percent of GDP in the NMS-10 (12), as well as the corresponding figure for the average of EU-15. In order to better identify specific developments, countries were grouped as follows: the five “Visegrád-countries” (V-5) in central Europe (left pane above), the three Baltic countries (B-3, right pane above), the two Mediterranean countries (M-2, left below) and the most recent entrants of the EU, Bulgaria and Romania (right below)\(^7\).

There has been an overall tendency of decreasing public deficits since the early 2000s, though the timing, extent and persistence of these fiscal corrections varies among countries. The average of the EU-15 showed some increase until 2003, but from than on there is a clear trend of falling deficits. The V-5 countries display a similar trend, with the sole exception of Hungary. In the Baltic countries deficits were very small, but they tended to diminish even further (Estonia recorded sizable surpluses in the last few years). Cyprus and Malta undertook impressive fiscal adjustments involving a correction of 8-10 percent of GDP between 2003 and 2007, in line with their successful effort to join the euro-zone in 2008. As for the latest entrants of the EU, Bulgaria’s performance is very similar to the Baltic countries’ (which is likely to be explained by the common adherence to the currency board system), while Romania displays similar features to the V-5 (central-European) countries.

The next question relates to the implications of the trends in the balance of the public sector for the changes in the size (expenditures) of this sector. In principle, deficits can be reduced by raising taxes and/or by decreasing expenditures. In order to observe the patterns under actual policy control (and disregard interest payments, which may be affected by the rate of

\(^7\) In addition to the NMS-10, developments in Bulgaria and Romania are occasionally also covered. These countries are not included in the detailed comparisons in the second part, as statistics on these countries are scarce. This applies for Cyprus and Malta as well, due to their rather different characteristics.
inflation\(^8\), developments in primary (i.e., non-interest) expenditures are presented in the following figure.

*Figure 1.6. Developments in primary expenditures in percent of GDP (2000-2007)*

The EU-15 average was characterised by a slight increase in non-interest government spending in the early 2000s, followed by a minor decline. In 2007 the primary expenditure ratio of the EU-15 was 43.3 percent, 2 percentage points higher than in 2000. While at the beginning of this decade five of the NMS had similar or higher spending ratios than the EU-15, by 2007 this ratio has become lower in all new members, except for Hungary. In Slovakia, in the framework of a comprehensive reform-package, radical reductions in the size of government expenditures were implemented: between 2000 and 2004 (the year of joining the EU) expenditures relative to GDP were cut by 11 (!) percentage points. Thus, in this respect Slovakia came close to the rather low levels characterising the Baltic region. In the rest of the countries adjustments were much less drastic, but there appears a general tendency: where expenditures were initially higher than in the EU-15, successful attempts were made to curb public spending. This is revealed by Figure 1.7, which shows deviations from the EU-15 average. Hungary, as mentioned, is an exception; in this country the primary spending of the government was subject to a political cycle (elections were held in 2002 and 2006 – see the figure below).

\(^8\) The higher/lower the rate of inflation, the higher/lower is the inflationary component that compensates for the inflationary erosion of public debt in nominal interest payments relative to GDP.
Before turning to questions concerning social expenditures, it is worth taking a look at the relationship between changes in the government balance (net lending) on the one hand, and changes in expenditures and revenues, on the other (Figure 1.8). The two panes of the figure, based on pooled data for the NMS, show that, by and large, both a decrease in expenditures and an increase in revenues was accompanied by improving fiscal balances. However, the first relationship appears to be much closer than the second one, suggesting that the “consensus view”, according to which expenditure cuts are to be preferred in curbing deficits, did actually show up in fiscal policies of the new members of the EU.

**Figure 1.8. The relationship between annual changes in expenditures (left pane), revenues (right pane) and in the balance of the general government in the NMS region, 2001-2007**

Source: own calculations based on AMECO database

1.4. Social expenditures in the new members of the EU in comparison with the EU 15

In this section we compare social expenditures between NMS and the EU 15. Recent developments in comparative levels/shares of two broad categories in public spending are to be reviewed: i) social transfers *in kind* (in statistical terms: “government individual
consumption”, GIC); and ii) social benefits other than social transfers in kind (i.e., cash-benefits, CB).9 These two types of transfers have to be treated distinctly in cross-country comparisons, both in terms of their relative (per capita) volume and their macroeconomic share. The reason is that relative international prices (purchasing power parities, PPPs) relevant for volume comparisons of the two categories differ among countries, especially if the countries compared are at different levels of economic development.

After discussing the statistical problems involved and presenting comparable indicators, we caution against rushing to judgements on the basis of these comparisons and touch upon the macroeconomic environment of developments in social expenditures in two of NMS-countries: Hungary and Slovakia.

1.4.1. Relative prices

Due to the importance of understanding the implications of cross-country differences in relative prices for international comparisons, we begin by clarifying and demonstrating some basic relationships. For readers who wish to skip methodological issues, we summarise the essential points of the discussion that follows:

If countries’ per capita real income (GDP/capita) is far apart, the relevant international price-ratio for comparing transfers in kind (i.e., the PPP for GIC) markedly differs from both that of the GDP (the average relative price level of the country) and from the PPP applicable for the comparison of cash-benefits. More specifically, this means that in the new members – with the exception of the three most developed NMS (Cyprus, Malta and Slovenia) – the relevant relative price for comparison of transfers in kind is much lower than that of GDP. The relative price (PPP) relevant for transfers in cash, in turn, is somewhat higher than the relative price of GDP. Regarding our subject matter, this implies that if a common conversion rate (i.e., the PPP for GDP) is applied for GIC and CB comparisons, then the per capita volume of social transfers in kind in most of the NMS (relative to the EU 15) is significantly understated (see Table A1.4), while that of cash benefits would be mildly overstated. To arrive at realistic comparisons, different PPPs have to be applied for per capita GDP, GIC and CB.10

Methodological issues: relative prices and the comparison of quantities and shares

We first treat methodological problems inherent in cross section comparisons of social expenditures between countries at different levels of economic development. Next, differences in relative prices and their consequences for international comparisons are discussed and illustrated. We also show how the assessment of the relative real level, share and structure of social expenditures depends on relative prices (purchasing power parities) applied for inter-country comparisons.

There are two seemingly straightforward ways for characterising the importance of certain macroeconomic items (e.g., specific government expenditures) in a country relative others: one is the comparison of per capita aggregates; the other is comparing ratios to GDP. It is generally understood that overall price levels differ among countries at different levels of development; therefore, per capita comparisons are carried out at purchasing power parities (PPP), rather than at nominal exchange rates. Still, the commonly applied PPP for these comparisons generally corresponds to the overall price level-difference (i.e., PPP for GDP),

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9 For the specific components of these transfers see Annex 3. (Generally, the bulk of GIC consists of expenditures on education and health.) It is important to stress that in the present part of the study we rely on macroeconomic statistics (national accounts and fiscal data), while the second uses statistics on social conditions. The two sources may occasionally differ.

10 The source for detailed PPPs is Eurostat (2008). As explained later, the PPP for “household final expenditure” is applied for the international comparison of the real value of cash benefits.
which does not account for differences in relative prices among countries. International comparisons based on ratios of specific expenditures to GDP suffer from a similar deficiency: they assume that by expressing the size of certain items as a fraction of GDP, differences in national prices are taken care of.

However, if the intention is to compare per capita volumes and/or real ratios to GDP, not only the difference in the general level of prices, but also in relative prices should be taken into account. This is essential in case of volume-comparisons aimed at clarifying the relative importance of items whose relative price significantly differs among countries.

In the context of our analysis, the problem of relative prices mainly applies to social expenditures involving transfers in kind by the government to households. As for social benefits in cash, we keep to the convention, according to which their comparative real value can be proxied by deflating with the relative level of consumer prices (i.e., the PPP for household consumption expenditures). Since, as shown below, the consumer price level and the price level of GDP are normally rather close to one another, there is generally no large harm in comparing per capita cash benefits at GDP PPP-s (or their nominal ratio to GDP). This is not the case with expenditures involving the provision of public services in kind (directly) to households. As the latter item is considerable in both the old and the new members of the EU, we begin by demonstrating the differences in price levels and relative prices between the new entrants and older members of the EU.

There are two kinds of relative prices that are relevant for international comparisons of real magnitudes: external and internal relative prices. External relative prices (or “price level indices”) refer to ratios of domestic to foreign prices of particular items (expressed in a common currency); internal relative prices, in turn, have to do with international differences in domestic price-ratios. For a more precise explanation of these terms see the Box below.

### Purchasing power parities, external and internal relative prices

**Purchasing power parities** (PPP-s) are price ratios of specific items (goods and services) between a particular (“home”) country and a “numeraire” country (or region). The PPP for GDP is derived as a weighted average of individual PPP-s for the major components of GDP. **International (external) relative prices** (also referred to as “price level indices”) are the ratios of PPP-s to exchange rates. That is,

\[
\text{PPP}_i = \frac{P_i}{P_i^*},
\]

\[
\text{PPP}_{\text{gdp}} = \sum \alpha_i \text{PPP}_i, (\sum \alpha_i = 1), \text{ and}
\]

the external relative price of a particular item is

\[
\text{RPe}_i = \frac{\text{PPP}_i}{E},
\]

where \(P_i\) and \(\alpha_i\) are, respectively, the domestic price, and weight, of the \(i\)-th component of GDP, the sign (*) indicates the numeraire country (region), RPe\(_i\) is the external relative price of the \(i\)-th component of GDP and \(E\) denotes the exchange rate (domestic currency per unit of foreign currency). The internal relative price, in turn, can be expressed as

\[
\text{RPI}_{(i,j)} = \frac{\text{PPP}_{(i)/\text{PPP}_{(j)}}}{\text{RPe}_i/\text{RPe}_j},
\]

11 Of course, there are serious difficulties in measuring and comparing the price of non-market services. These problems are present in domestic comparisons over time as well. On these see the guidelines in paragraphs 10.34, 10.41 and 10.46 in ESA 95.
where $i$ represents a specific item (e.g., “services”) and $j$ can either represent another specific item (e.g., “goods”) or the PPP for (external relative price of) the GDP. 

In international comparisons, PPP-s (or external relative prices, i.e., PPP/E-s) are (should be) used for cross-country comparisons of quantities (e.g., per capita volumes), while internal relative prices serve for comparing relative shares at common/comparable prices.

**Empirical relationships for the NMS vs. EU-15**

We now show the empirical relationship between per capita GDP on the one hand and the external relative price of GDP, as well as that of “government individual consumption” (GIC), i.e. provision of public services to households (the bulk of which is expenditures on education and health), and household consumption expenditures (HCE), on the other. In the next step we turn to the implications for internal relative prices.

As portrayed by Figure 1.9, there is a close relation between the volume of per capita GDP (GDP converted at PPP) and external relative prices.

**Figure 1.9. Relative (external) prices(RPe) in function of relative real per capita GDP in 2006 (EU15=100)**

1.9 (a). RPe of GDP  
1.9 (b). RPe of GIC*/ and HCE*/

*/ Notations: GIC: government individual consumption expenditures (= social transfers in kind); HCE: household consumption expenditure  
Source: Calculations based on the Eurostat database

The figure on the right hand side indicates that higher relative real per capita income involves a higher overall relative external price level. The one on the left shows that the pattern of external relative prices also depends on the level of development. In poor countries the external relative “price” of transfers in kind is much lower than that of household consumption expenditure. This association is revealed by Figure 1.10.

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12 For more on PPP, relative prices and the specific PPP of the EU (termed “Purchasing Power Standard”, PPS), see Annex 3 and OECD-Eurostat (2005 and 2006).  
13 Annex 2 treats some questions related to PPPs relevant for the international comparison of the structure of prices and expenditures vs. PPSs for comparing the level of prices and expenditures.  
14 The PPP (or RPe) for household consumption expenditure in cross-section comparisons roughly corresponds to the concept of the consumer price index (CPI).
The interpretation of these ratios is the following. If the external relative price of GDP \( (\text{P}_{\text{gdp}} = \text{RPe}_{\text{gdp}}) \) is applied for international comparison of social transfers \textit{in cash}, its real value is overstated in all of the new member countries by using the PPP for GDP. This is so because in all of the NMS the relative external price of household consumer expenditures is higher than that of the GDP (though the extent differs). If, in turn, social transfers \textit{in kind} are compared between NMS and the EU15, their actual volume is significantly understated by using PPP for GDP as a measure of comparison. The \textit{overstatement} in the real comparative value of cash transfers and the \textit{understatement} in that of transfers in kind both depend on the \textit{general level} of relative prices, but these relationships are far from being mechanical.

Figure 1.11 supports this contention: it plots the internal relative price ratio of GIC to HCE in relation to the external relative price of GDP.

\[ y = 0.9x + 14.036 \quad R^2 = 0.7809 \]
\[ y = -0.2435x + 122.05 \quad R^2 = 0.5759 \]

\[ y = 1.0033x + 3.6484 \quad R^2 = 0.8614 \]

Generally speaking, the higher the GDP-price level, the higher is the relative internal relative price of GIC to HCE. But around 50-60 percent of the external relative price of GDP, there appears to be no relationship at all – at least in 2006 (the last year for which comparable data for these items are available). Figure A1.1 in Annex 1 shows the evolution of these price ratios for individual countries in the period 2000-2006. Strictly speaking, the consecutive yearly ratios cannot be treated as ordinary time series, as they serve for cross-section
comparisons in each year, rather than for comparisons over time. However, it is not their actual magnitude, but their overall tendencies that matter for the purpose of our study.

1.4.2. Relative per capita volume and share of social transfers

In what follows three indicators are applied for characterising the importance of two broad categories of government social transfers (GIC and CB) in the NMS relative to the EU 15. These are: i) per capita volumes, ii) relative shares to GDP, and iii) a combination of these indicators. The indicators (volumes, shares) are mostly based on “appropriate” PPPs, meaning that each aggregate (GDP, GIC and CB) is measured/compared at its own PPP. This is expressed by referring to “volumes” or “real” shares. In some cases both “nominal” and “real” comparisons will be presented. In this context “nominal” comparison means that shares/ratios are measured at domestic prices.

Social transfers in kind: relative per capita volumes

The general picture regarding the volume per inhabitant of transfers in kind (as compared to the EU 15) in NMS for the period 2000-2006 is shown in Figure 1.12 (for country-specific details see Table A1.4 in Annex 1)

In two countries, the Czech Republic and Hungary per capita expenditures have been very close to that of the EU 15 (85-95%). Slovenia is at about 75%, while Poland and Slovakia are at 60% of the EU 15 average. In the Baltic countries, the respective level of Estonia and Lithuania corresponds to that of Slovenia, and that of Latvia to Poland and Slovakia. In this respect Malta is close to Slovenia, while Cyprus (around 50%) is rather close to Bulgaria and Romania (40-50%). For most of the countries, the relative per capita volume of social expenditures in kind appear to be rather stable (with temporary fluctuations), but in some cases certain tendencies can be discerned. In particular, in the Czech Republic a sharp downward correction can be observed since 2004; and in 2003 a similar correction took place in Slovakia.

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15 Formally: i) \((ST_i/Pop_i)/(ST_{EU}/Pop_{EU})\) across NMS; ii) \(ST_i/GDP_i\) relative to \(ST_{EU}/GDP_{EU}\); iii) \((ST_i/ST_{EU})/(GDP_i/GDP_{EU})\) = \( (ST_i/GDP_i) : (ST_{EU}/GDP_{EU})\) across NMS. Notations: ST: social transfers, Pop: population, \(i\) and \(EU\), respectively, refer to NMS country \(i\) and to the EU-15 average.
While these ratios are interesting in themselves (especially the information indicating that in two of the NMS the per capita volume of GIC-expenditures are almost at the level of the EU 15), they should be interpreted in light of two important facts. On the one hand, in most of the NMS per capita GDP is much lower than in the EU 15, but GDP grew much more rapidly than in the EU 15 over the period under review, on the other. These facts can be taken into account by considering the second and third indicator referred to above: “real” shares and deviations from levels implied by relative per capita GDP.

**Comparison of ratios and deviations of levels implied by relative GDPs**

The basic information is provided by Figure A1.2 in Annex 1, while Figure 1.13 (and A1.3) displays derived indicators regarding comparisons between the NMS and EU15. As shown by these charts, in the majority of the central-European NMS (the V5-countries), the per capita volume of social transfers in kind (GIC) was much higher than implied by their relative level of development in the early 2000s (the sole exception is Slovenia). This statement holds even more forcefully for the Baltic (B3) countries. (E.g., in the Czech Republic, the relative per capita volume of these types of transfers was by 90%, and in the Baltic countries by 100-120% higher than what would have corresponded to the per capita GDP relative to the EU 15.) However, over the 2000s a very rapid and steady decline in this “discrepancy” could be observed in several countries, especially in the Czech Republic, Slovakia, and in the B3 countries.). In Hungary and Poland there was a halt in the declining trend in the mid 2000s.

Regarding the relative per capita volume of social transfers in cash (as compared to per capita real GDP), in most of these countries they were relatively low in the early 2000s, and there are no clearly identifiable general trends, except for Hungary and Slovakia. In the former country a continuous increase, in the latter a sharp discrete fall could be observed.

16 See Annex 2 for some technical caveats regarding the comparison of structures.
1.4.3. The importance of the macroeconomic and economic policy environment of social transfers

After having presented some comparable indicators of social expenditures, we have to stress that these provide limited information on the soundness of government policies or their actual (social) impact. To offer an example, we refer to the contrasting experiences of Slovakia and Hungary. As shown in the foregoing, over the last few years social expenditures, by and large, fell in Slovakia, while they increased in Hungary. The tendencies in the two countries are revealed more clearly by the evolution in the ratio of total expenditures on social protection to GDP. For comparison, we added data on the Czech Republic and Poland as well. Since these countries are at similar levels of economic development, the comparison is not really affected by differences in price-structures.

Figure 1.14. The share of social protection expenditures in GDP in the V-4 countries, 2000-2006

Source: Eurostat
Changes in the share of spending on social protection may appear to suggest that Hungary’s policy-makers were more concerned by social problems than those in Slovakia and the other two countries. While this may, or may not be the case, some rough indications of social inequality suggest that the situation, at least in this dimension, is not worse in Slovakia than in Hungary. (Of course, as discussed later on, social transfers can be made by tax concessions as well.)

*Figure 1.15. Two indicators of social inequality: the highest and the lowest quintile share ratio* and the Gini coefficient** in the V4 countries in 2006 and 2007*

* The ratio of total income received by the 20% of the population with the highest income (top quintile) to that received by the 20% of the population with the lowest income (lowest quintile). Income must be understood as equivalised disposable income.

** The Gini coefficient is defined as the relationship of cumulative shares of the population arranged according to the level of income, to the cumulative share of the equivalised total net income received by them. It varies between 0 (if everyone gets an equal share of total income) and 100 (if all income goes to one individual only).

Source: Eurostat

This leads to the next observation: in Slovakia the decline in the relative size of social expenditures took place in the context of decreasing total government spending (see Table A1.3 in Annex 1) and was accompanied by a reform of the overall tax system, resulting in a substantial fall of the tax burden (Figure.1.16).

*Figure 1.16. Total tax burden in the V4 countries (in % of GDP)*

The fall in the tax burden, in turn, is likely to have been an important factor contributing to the outstanding growth performance in Slovakia. After 2004, economic growth accelerated spectacularly in Slovakia, while it significantly slowed down in Hungary. One of the reasons why Hungary’s fiscal consolidation of 2006-2007 resulted in a marked fall in GDP-growth
was that it involved a sharp increase in the tax burden and but a limited decrease in the extremely high rate of expenditures.

Figure 1.17. Annual change in real GDP in the V4 countries

The higher rate of economic growth in Slovakia had two important economic and social effects: the significant fall in the unemployment rate and the sizable increase in the employment rate. In the meantime, Hungary’s unemployment increased somewhat, while its low rate of employment practically did not change during the period reviewed (Figure 1.18).

Figure 1.18. Unemployment and employment rates the V4 countries

Naturally, the foregoing overview of some facets of macroeconomic developments is not intended to give an explanation of the contrasting performance of the V4 countries; it is rather meant to call attention to the broader macroeconomic environment and the economic policy context of social indicators. The lesson is clear, though the actual implementation is far from simple: a growth-enhancing economic policy may eventually decrease the need for certain social transfers, while it potentially expands the sources for assisting those, who are in need.

1.5. Provisional summary and implications for the detailed analysis

The relative positions and trends shown in the foregoing are pieces of background information for the more detailed analysis of social transfers affecting children, to be covered in the next part of the study. The general picture shown by the data is that the former socialist countries, even 10-15 years after the transition, are different from the EU-15 regarding the macroeconomic importance of social transfers. This statement mainly applies to social transfers in kind: their per capita level (and share in GDP) is still significantly higher than
levels/shares corresponding to these countries’ relative per capita real GDP. However, recent tendencies in the period 2000-2006 clearly point downward in both central Europe and the Baltic countries (with Hungary being an exception). This decline in most of the countries is the result of the more rapid growth of GDP than that of social transfers; in this respect the Czech Republic and Slovakia are exceptions (where the share of social expenditures – especially cash-transfers in Slovakia – fell more than implied by faster GDP growth).

The most important methodological implication of the foregoing for the analysis in part 2 concerns relative international prices (PPPs) relevant for comparison of social expenditures in kind. Since no individual PPPs are available for the international comparison of specific items for social expenditures related to children, we simply call attention to the fact that for most of the NMS, the actual volume of social transfers in kind are generally understated if these items are converted at the PPP for GDP. For two important items within transfers in kind, namely health and education, Figure 1.19 shows ratios to GDP measured at both domestic and international (OECD average) prices. In most of the NMS, the ratios are much higher if average international relative prices (that is, PPPs for the two specific items), rather than domestic prices are used for comparing the share of these two major items of social expenditures.

*The real shares are obtained by using “GK-PPPs”; see Annex 2.
Source: OECD database (2008)*

Finally, we have to stress that indicators regarding the comparative evolution of social expenditures among countries provide limited information on the soundness of government policies or their actual (social) impact. This is so because relative levels of (changes in) these expenditures affect the economy and society in the context of an overall economic policy. That is, rising social expenditures may reveal an increase in “social compassion” of the society (or that of policy-makers), but it may also be a reflection of misguided macroeconomic policies, leading to higher unemployment. The opposite case (a fall in the relative size of social expenditures) may be explained by economic success (e.g. lower unemployment), or changes in political preferences (less attention towards the poor part of the population). The relative general indicators reviewed in the foregoing, by themselves, do not give a clue to establishing which of these explanations (or what combination of the possible explanations) holds for a particular country. Understanding actual developments necessitates country-by-country analyses.
2. Specific issues and policies related to social expenditures with particular relevance for children

In the second part of the analysis we focus on policies and expenditures related to children. Before turning to a detailed investigation of the various functions of social protection expenditures, we briefly review the main policy considerations and trends underlying social expenditures related to children. Next, we discuss social expenditures and their development in the NMS, following the approach of the previous section. The paper concludes with some policy implications of the issues reviewed.

2.1. Social and economic policy consideration connected to children

Policies related to children, eminently child poverty, is an important issue in the EU, as well as in the OECD or the UN: a major objective of these institutions is related to policies regarding families and children. (European Commission 2008, 2002, United Nations 2007 UNICEF 2005, 2007) Social protection is a distinctive feature of the European social model; common objectives are set for social inclusion (as a part of the open process of coordination). However, responsibility for tax and benefit policy and taxation connected to the same targets lies principally with Member States (European Commission 2002). Consequently, priorities and measures taken to achieve particular goals of social protection vary significantly across countries. The differences are connected to the nature and scale of social problems, differences in the economic circumstances, the nature of existing tax and benefit systems, but also to political and social attitudes towards social protection and income redistribution regarding children. The respective general differences across the EU 15 and EU 10 countries, partly related to the convergence criteria and fiscal consolidation of the NMS, has already been discussed earlier in this paper. The overall trend often involved unavoidable cuts in social expenditures in the EU10. This has raised important questions related to social policy: which groups are affected by the decline in social expenditures, and by what particular measures?

It is difficult to identify any economic or social policy that would not affect – directly or indirectly – children or the households the children are living in. Some policies are aimed at the general well-being of children, including education, health or the quality of life of youth connected to children. Others are more directly targeted to families with children by reducing the costs and burden of bringing up children. The targets of these kinds of policies are, on the one hand, a general support for children to compensate the cost of childbearing. On the other hand, policies are aimed at children or families with children at risk.

Gábos et al (2007) classify children-related policies by distinguishing various public interventions as follows: i) regulations ii) cash or near cash benefits and iii) in kind benefits. Regulations depend on countries’ policies and their specific political, social and economic preferences and, as an outcome, the way they regulate labour market institutions, healthcare, maternity and/or parental leave etc. Cash (or near cash) benefits are given for compensation of particular needs or risks; and recipients can decide freely how to spend the compensation. In-kind benefits, in turn, are services the use of which recipients can only decide in the moment needed. Depending on the need and circumstances of the recipient he/she may enjoy or miss the benefits in kind; this is a sensitive issue of social policy and protection.

Policies can have different underlying reasons and their objectives may also differ. Some policies aim directly at affecting income levels through the tax and benefit system. Other policies promote access to jobs and employment; according to these, labour market policies are essential in finding permanent jobs that determine the elevation of children and their well being. Some further policies aim to tackle long term disadvantages. Policy considerations and targets regarding compensation and/or alleviation of child poverty often largely depend on
methods of measurement and indicators selected (income, consumption unit, poverty threshold, intra household share of resources and social exclusion, as well as the time horizon considered.)

Gábios et al (2007) summarize the related literature on assessment of policies in alleviating child poverty and sum up the main questions regarding policy evaluations. Primarily, the investigation should try to clarify how far policies achieved their goals connected to the indicators set. E.g., assuming that the employment status decreases vulnerability, the main target should be directed at improving work incentives, if employment/lack of work of the parent(s) is the main factor determining (or elevating) the poverty of the family. Notwithstanding the importance of the general target of employment promotion, the main direction of social expenditure policy should be the efficiency in spending the benefits. It has to be taken into consideration that the welfare system of various countries/regions and performance and policies and measures largely differ. Finally, time horizon also matters for the policy outcome.

There is a general consensus on principal factors affecting child poverty. Policies are largely based on these assumptions. Economic growth and general economic environment, labour market policies and individuals’ labour market position, demographic trends and household composition, labour market failure in finding jobs, wage structure and low wages are widely studied and proved to have been connected to child poverty. Furthermore, there is consensus on the effectiveness of welfare state policies with the common conclusion that child poverty rates would be much higher if there were no child contingent transfers in place 17. Government policies and transfers appear to account for most of the variation in child poverty rates. In addition to transfers, support through tax concessions is common in most of the countries. Non-child contingent benefits (old-age pension, unemployment benefit or social assistance) are also accompanying and vary considerably by countries and in terms of the form they take.

Child-related supports are channelled in various ways; these have a strong effect on the distribution across households. The redistribution effect, i.e., support of poor families with children can be better achieved by a benefits payment. These are more likely to channel income to the children of the poor families or to families at risk. Means tested benefits have proven to be the best method for redistribution. Tax concessions are more likely to support the better off families; flat tax rates have similar consequences. Shifting family support from the benefits to tax concession would decrease work incentives, may involve distortions and lead to poverty traps.

However, the assessments rarely address the cost and benefits of the policies, although this is crucial, especially in the majority of EU 10 countries, with the heritage of generous benefits relative to their level of development and with scarce sources for social expenditures. In this context policy debates on the effectiveness of addressing the benefits to targeted groups increase the role of means-tested benefits, while giving preference to general and universal benefits is unsettled. Rich welfare states, with more generous systems provide most of the support through non-income related benefits. Universal benefits can be considered to be an appropriate tool to support children in general, and to fight child poverty in particular, given their efficient provision on a regular basis, as well as the absence of social stigma and their

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17 Child-contingent income is defined as the parts of the tax and benefit system that households receive because of the presence of children. This includes more than payments which are labelled as family benefits since some other benefits contain complements for children. It also includes tax concessions as well as benefit payments. In practice, therefore, all cash payments made because of the presence of a person aged under 18 in the household are considered as child-contingent payments. (Applica 2007) In the present paper we are restricted to social benefits, and tax transfers will not be investigated, but we should note the importance of this policy measure. (See a more detailed policy description in Applica 2007)
high take-up. Means-tested instruments, in turn, represent an efficient way of targeting support on the most needy, despite having higher costs in terms of non take-up and adverse impact on employment incentives.\textsuperscript{18} However, means-tested benefits are tools that may lead to poverty traps and avoid support for those less responsive to benefits. Among the circumstances of scarce resources and expenditures, the preference is even more ambiguous. Countries targeting more, use the resources spent more efficiently, but overall poverty rates tend to be higher, because they spend less in total. Benefits differ by regions. Means tested benefits are more common in countries/groups of countries where social policy regime is more responsive to testing benefits. (E.g. in English speaking or Mediterranean countries in contrast to the Nordic countries, Applica 2005, UNICEF 2006, Gábos et al 2007.) EUROMOD country report on EU 15 shows that universal benefits are not common in Southern Europe (Italy, Portugal and Spain), while all other countries provide various forms of cash benefits (European Commissions 2008, Annex 1, Table 2).

A further important methodological issue concerns how in-kind benefits – like access to government-financed education, health care or housing allowances, etc. – can be added to (included into) total benefits, and how “total income”, including these items, can be compared internationally. For these methodological reasons, in-kind benefits are rarely included into household resources. Chapter 9 of OECD (2008) gives some evidence on the effect of public services that significantly narrow inequality to households, although this reduction is typically lower that that achieved by the combined effect of household taxes and public cash transfers. The main reason is the relatively uniform distribution of these services across the population. Garfinkel et al (2004) found that non-cash benefits (on health and education, including early childhood education) substantially reduced differences in child poverty between countries, but did not eliminate them. These findings correspond to the evidence of our comparisons concerning transfers in kind, based on “proper” PPPs, presented in the previous section.

In the following sections we focus on social protection benefits with special attention to children. This approach corresponds to the mainstream interpretation of social policies focusing on the vulnerability of children, avoiding poverty and social exclusion of families. (Commission Communication, 2007)

2.2. The social situation of children in the EU 15 and EU 10

Policy considerations are strongly influenced by the economic and social situation in individual countries. A recent publication of the EU gives detailed comparative indicators on the social situation of the EU 10 and EU 15 based on the SILK data\textsuperscript{19}. (European Commission 2008) For a synthesis of the evidence, we show the grouping of countries depending on how child poverty relates to the overall poverty rate and to the EU (weighted) average.

Five of the EU 10 countries (Hungary, Lithuania, Malta, Poland and Slovakia) show a poverty rate for children that is both more than 5 percentage points higher than the overall population and higher than (or equal to) the EU average. In the Czech Republic child poverty is below the EU average, nevertheless, child poverty is significantly higher than that of the total population. In Estonia and Latvia child poverty is not below the EU average, but the risk of children is not significantly higher than that of the overall population, and only in Cyprus and Slovenia are children in a better situation, where child poverty has no significant risk. Table 2.1. shows the grouping of countries by poverty rates for children. The results indicate that in

\textsuperscript{18} For a detailed discussion of the British reform see Brewer et al (2008). The report addresses work incentive issues, but also the administrative failures that were identified.

\textsuperscript{19} EU-SILC stands for European Union Statistics on Income and Living Conditions and provides comparable, cross-sectional and longitudinal multidimensional data on income, poverty, social exclusion and living conditions in the European Union.:
the EU 10 countries (with the exception of Cyprus and Slovenia) child poverty is a serious problem, and not simply in European comparison, but also for the respective countries themselves. According to the report, all countries with a child poverty rate that is higher than both the EU average and the overall population have identified child poverty as a key challenge in their 2006-2008 National Strategy Report, and described the different measures they are planning or have already put in place to address this issue.

Table 2.1. National child poverty rates versus EU child poverty and versus overall national poverty rates (2005)

<table>
<thead>
<tr>
<th>Child poverty is below EU average</th>
<th>Children are at a lower risk than (or equal to the overall population)</th>
<th>Children have a higher risk of poverty than the overall population (&lt;=5%p)</th>
<th>Children have a higher significantly higher risk of than the overall population (&gt;=5%p)</th>
</tr>
</thead>
<tbody>
<tr>
<td>DK, RF, SE, CY, SI</td>
<td>BE, DE, FR, NL, AT</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Child poverty is above (or equal to) EU average</td>
<td>EL</td>
<td>ES, IT, PT, IE, UK, EE</td>
<td>HU, LT, MT, PL, SK, LU</td>
</tr>
</tbody>
</table>


2.3. Social protection expenditures in the EU 10 and EU 15

In this section, focusing at social protection expenditures related to children, we base our comparison on the EU data collection covering social protection expenditures by functions (based on ESSPROS European System of integrated Social Protection Statistics). 20 EU data on social protection expenditures cover cash versus in-kind as well as means-tested versus non means-tested benefits; all of these will be considered in our analysis. Social protection expenditures cover not only social benefits, but also administrative costs and other expenditures. Nevertheless, the bulk of these expenditures cover benefits; we shall neglect other elements of total expenditures (like administrative costs).21

2.3.1. Social protection expenditures – general overview

The main fields of risks or needs that may give rise to social protection – as fixed by conventions and followed by the EU data collection – are the following 1) sickness & health care, 2) disability, 3) old age, 4) survivors, 5) family & children (that follows more in details), 6) unemployment, 7) housing and 8) social exclusion not elsewhere classified. According to the EU 15 average data (in 2005), as benchmark, the largest share of total benefits (over 40%) goes for old age pension. For the purpose of our analysis old-age pension should be excluded from children-related benefits, and considered as family earnings instead of social transfers)22. The second largest field of need is sickness and healthcare (almost 30%). The rest of social protection expenditures is divided among the other needs and risks: invalidity (on average 8%), survivors (on average 4.5%), family & and children (8%) and unemployment (on average 6%) of the total protection benefits. A small share of benefits goes to housing support (over 2%) and social exclusion that was not classified elsewhere (over1%, on average). Share and total amount differs considerably across countries according to country specific policies.

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20 Social protection covers all interventions from public or private bodies intended to relieve households and individuals of the burden of a defined set of risks or needs (defined in the ESSPROS Manual 1996 and used in data collection). Data on social protection expenditures provide data for analysing and comparing social protection financial flows, but the efficiency of using the expenditures are not measured. Data are based on national administrative sources (see annex 3).

21 Share of other expenditures other than benefits (e. g. administrative costs) do not exceed 5 % of total social expenditures the EU.

22 The approach was similar in European Commission (2008)
and economic wealth and situation (see the share of various targets of expenditures in Figure 2.1).

**Figure 2.1. Breakdown of social protection benefits by share of various functions, 2005**

![Breakdown of social protection benefits by share of various functions, 2005](image)

Source: Eurostat database, 2008, social protection expenditure

Total expenditures on social benefits in the EU 10 and EU 15 countries have a different trend over the period of 2000-2005. Compared to the EU 15 average (at GDP-PPP), in the less developed countries of the EU 15 benefits are increasing and converging to the EU 15 average (Spain, Greece, Ireland, Portugal), where the expenditures are still considerable below the average of the EU 15, and stable in the other countries. As for the EU 10, we see similar convergence to the EU 15 in Slovenia and Cyprus, to a smaller extent in the Czech Republic and Hungary, and to a much slower extent, near to stagnation, in the rest of the EU 10 (even considering the different price levels and their structures, see Figure 2.2).

**Figure 2.2. Total social protection benefits per head in the EU countries, 2000-2005 in PPP, base line = EU 15 in 2000**

![Total social protection benefits per head in the EU countries, 2000-2005 in PPP, base line = EU 15 in 2000](image)

Source: Eurostat database, 2008, social protection expenditure

Not only are the expenditures below the EU 15 average in the EU 10, but so is the share of expenditures to GDP. With the exception of Cyprus, Malta and Hungary the social protection expenditures in GDP per head is decreasing in the EU 10 countries, contrary to the trend of the EU 15 countries. Figure 2.3 shows social protection expenditures of the EU 10 and that in

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23 Here we compare the amount of the expenditures according to the common method and even comparing total social protection benefits that comprise old age pension. Both will refined in the analysis.
the EU 15 in percent of GDP per head. Nevertheless, the trend corresponds to public budget targets of the EU 10 countries, as discussed in the first section. Differences in the NMS are essential and show a diverse trend in several EU 10 countries.24

**Figure 2.3. Social protection benefits in % of the GDP per head, EU 10, EU 15**

Source: Eurostat database, 2008, social protection expenditure

### 2.3.2. Social protection expenditures by functions – details

In the following we discuss social protection expenditures of the EU 10 countries by functions, compared to the EU 15 average. As a consequence of needs, preferences and/or historical heritage, trends of different social protection functions vary by countries. Most of the social protection benefits are targeting or influencing indirectly children’s well being or social inclusion. Children are partly the target group of sickness and health care expenditures or those benefits that are compensating social exclusion like unemployment, survivors or invalidity benefit, as well as housing or other social exclusion protection benefits. Children are more directly targeted by youth and family protection expenditures, the components of which are treated in the next chapter. Differences by countries are considerable. (Table 2.2)

**Table 2.2. Social protection expenditures in % of the GDP**

<table>
<thead>
<tr>
<th></th>
<th>EU-15</th>
<th>Slovenia</th>
<th>Hungary</th>
<th>Poland</th>
<th>Czech R.</th>
<th>Slovakia</th>
<th>Bulgaria</th>
<th>Romania</th>
<th>Lithuania</th>
<th>Estonia</th>
<th>Latvia</th>
</tr>
</thead>
<tbody>
<tr>
<td>Old age and survivor’s pension</td>
<td><strong>12.2</strong></td>
<td>10.2</td>
<td>9.1</td>
<td>11.5</td>
<td>7.9</td>
<td>7.0</td>
<td>7.9</td>
<td>5.7</td>
<td>6.0</td>
<td>5.4</td>
<td>5.7</td>
</tr>
<tr>
<td>Sickness and disability benefits</td>
<td><strong>9.8</strong></td>
<td>9.4</td>
<td>8.5</td>
<td>5.8</td>
<td>8.0</td>
<td>6.3</td>
<td>5.8</td>
<td>6.0</td>
<td>5.2</td>
<td>5.1</td>
<td>4.2</td>
</tr>
<tr>
<td>Family/children allowance</td>
<td><strong>2.2</strong></td>
<td>2.0</td>
<td>2.5</td>
<td>0.8</td>
<td>1.4</td>
<td>1.9</td>
<td>1.1</td>
<td>1.4</td>
<td>1.2</td>
<td>1.5</td>
<td>1.3</td>
</tr>
<tr>
<td>Unemployment benefit</td>
<td>1.7</td>
<td>0.7</td>
<td>0.6</td>
<td>0.6</td>
<td>0.7</td>
<td>0.7</td>
<td>0.3</td>
<td>0.4</td>
<td>0.2</td>
<td>0.2</td>
<td>0.5</td>
</tr>
<tr>
<td>Housing and social exclusion</td>
<td><strong>0.9</strong></td>
<td>0.7</td>
<td>0.7</td>
<td>0.5</td>
<td>0.6</td>
<td>0.5</td>
<td>0.4</td>
<td>0.3</td>
<td>0.2</td>
<td>0.1</td>
<td>0.2</td>
</tr>
<tr>
<td><strong>total in % of the GDP</strong></td>
<td><strong>27.8</strong></td>
<td>23.4</td>
<td>21.9</td>
<td>19.6</td>
<td>19.1</td>
<td>16.9</td>
<td>16.1</td>
<td>14.2</td>
<td>13.2</td>
<td>12.5</td>
<td>12.4</td>
</tr>
</tbody>
</table>

Source: Eurostat database, 2008, social protection expenditure

*Old age and survivor’s pension* form the largest share among the conventionally defined social protection expenditures in all the EU countries. As we defined above, from the point of view of the children related social expenditures pensions should better be considered as part of the family earnings instead of social transfers although level of old age pensions matters. Except Slovenia, Hungary and Poland the share of pension in GDP per person is considerable behind the share of the EU-15 (in Poland the share of survivor’s pension is very high). It has

24 We should remind here that total data includes old age benefits, consequently the trends are largely influenced by pension reforms of individual countries, but this issue is beyond the scope of the present paper.
an important influence on multigenerational household’s family income. Family size and share of multigenerational household vary considerable in the EU: the lowest is its share in Northern and Western Europe and higher in the Mediterranean countries and in some of the EU 10 (Baltic countries, Slovakia, Poland). More detailed data for the EU 15 show that a large group of countries have rates of co-residence with adult siblings but co-residency with other adults is more common in the Southern countries, but also in Austria, Ireland. (Figure 2.4)

**Figure 2.4. The proportion of households with children and adults in addition to their parents, EU15**

[Graph showing the proportion of households with children and adults in addition to their parents, EU15]


The share of pension (as a percentage of per capita disposable income by benefits categories per child is marginal in the Western and Northern EU countries and significantly higher (2-4%) in the less developed Southern countries of the EU, where multigenerational families are living. (No data is available for the EU 10; for EU 15: EUROMOD calculations, cp. European Commission 2008, p 183) The share of pension in gross income (without redistributive impact of taxes and contributions) in poor households with children is also higher in the Southern EU 15 countries and similarly, in some of the EU 10 e.g. the Baltic countries, Slovakia, Poland (based on EU-SILK 2005 data cp. European Commission 2008, p. 157). Elder persons on pension (or other co-resident adults) may be net contributors to household income or net users of household resources. Lazear and Michael (1988) emphasize that the division of consumption between parents and children is affected by the number of adults in the household: as the number of adults rises, the children’s share declines proportionately.

**Sickness and healthcare protection** expenditures are considerable large part of social protection expenditures related indirectly to children and they are in all EU 10 countries considerably below the EU 15 average (per head, in PPP). Except Slovenia and the Czech Republic all other countries are below 50% of the EU 15 average and hardly converge; a small increase came about in some of the countries (Hungary, Latvia, Cyprus) but no change in the others; and in Slovakia expenditures drop sharply.

Expenditures transferred to other social protection targets are much smaller (as a % of the GDP). **Unemployment protection** has an indirect effect on the children through the circumstances of living in unemployed households. EU 10 countries are more uniform with low unemployment benefit expenditures compared to the EU 15 level and very low in the
Baltic States or sharply decreasing like in Poland. More generally, unemployment and labour market situation of parents is a key determinant of the conditions in which children live and develop. The low level of unemployment benefits in the EU 10 adds to vulnerability of children of jobless parents.

Social exclusion compensation is low in share of social expenditures and extremely low in the EU 15. In contrast, in the EU 10 countries social exclusion compensation expenditures are strongly increasing and approaching or even exceeding the EU 15 average (in some more developed new member countries like Cyprus, Slovenia or the Czech Republic) while sharply decreasing in Slovakia or in Poland. Other countries in the region show stagnation in the social exclusion compensation at a relatively low level.

Finally, direct family and children protection benefits present a more colourful picture, with very different level of expenditures. Some EU 10 countries are converging to the EU 15 level (Cyprus, Slovakia, Estonia, Lithuania), while some countries like Slovenia, Cyprus and Hungary are approaching or reaching three-fourths of the EU 15 protection expenditures (per head, in PPP). Other EU 10 countries have a low or even very low level of children and family protection benefits and some are also diverging from the EU 15 average (Malta, Poland).

To sum up, social benefit-expenditures are considerably lower in the EU 10 countries than in the EU 15, comparing the expenditures measured at a PPP for GDP (taking into consideration the differences in the general price level of the countries, see. Figures A1.4 a)-d) in Annex 1). As discussed in the first part of the paper, the differences in in-kind benefits necessitate even more careful comparison due to the price differences across services in the EU 10 and EU 15. Annex 1 Figures A1.5 a)-d), show the share of in kind benefits of various functions of benefits and differences are essential. In sickness and health care, 80-90% of the expenditures are in-kind benefits, what means that we may suppose a lower difference in real terms than what is shown by the respective figures. (See the analysis in the first part of the study and Annex 2.) In case of other functions of social protection benefits, like unemployment or children and family benefits, the share of in-kind benefits are considerably lower, 20-30% of the total, or even less. As for family and children-targeted benefits, the share of benefits in kind seems to be below the EU average in most of the EU 10 countries. (Since the share of in kind benefits were calculated on national prices the comparisons underestimates the share of in kind benefits. Still, in the NMS cash benefit transfers for families and children appear to be more common than in the EU 15. As a consequence of the low share of in-kind benefits, comparison at PPP-GDP is more realistic and the lessons we can draw are more reliable. In the case of the relatively small social exclusion compensation expenditures, the share of in-kind benefits strongly differ by countries, especially in the case of Hungary or Lithuania, where the share of in-kind benefits is high, or Malta, where a sharp increase or Poland where a strong decrease in the share of this item came about in recent years. The share and the change of children-related social expenditures in percent of the GDP depend largely on social policy decision of the countries. Not only are the social protection benefits below that of the EU 15 level using any measures to compare, the share of expenditures in GDP are also lower in the EU 10 than in the EU 15 in the main sources of children related benefits (that is, in sickness and health, in family and children and related benefits as well as in unemployment benefit expenditures). Social exclusion compensations show a somewhat different picture: this kind of compensation is more important in the EU 10 countries especially in Cyprus, Slovenia.

Unemployment benefit expenditures depend on the level of unemployment as well as the generosity of the regime of unemployment compensation that can not taken into consideration in the rough comparison. Nevertheless, generosity of unemployment benefits has been reshaped in most of the EU-10 countries; cuts in benefits took place in the EU-10, but also in the EU-15 countries with a strong welfare model.
or the Czech Republic and until recently in Slovakia, where a sharp drop came about in these benefits as well. At the same time, children and family-related benefits were sharply increasing in Slovakia and also in Cyprus; they remained around the share of the EU 15 in Slovenia and even above the EU-expenditures in Hungary. (See Figure 2.5 a)-d)

2.3.3. Social protection benefits directly related to children

Social protection benefits directly related to families or children cover cash benefits and also benefits in kind, in particular i) periodic cash benefits in connection to the child birth and parental leave, family or child allowance and some other benefits and ii) lump sum cash benefits like birth grant or parental benefits and iii) benefits in kind like child day care, accommodation, home help and some other benefits in kind.

Cash benefits related to families and children are fundamental in total children and family targeted benefits in most of the EU 10. They are much above the EU 15 average in Poland, Slovakia or Estonia and only in Hungary, Slovenia or Lithuania is the share of in-kind benefits similar to the EU 15 average. Figure 2.6 shows the share of cash benefits in family & children benefits, compared to the base line of the EU 15 average, the EU 10 countries indicated with (◆). With the exception of Cyprus, over 90% of cash benefits are mostly periodic benefits.
The trend in the share of cash benefits (in PPP per head), as a general indicator of policy connected to children is shown by Figure 2.7. The share of cash benefits, as a general trend, is decreasing in the EU 15 and in some of the EU 10 countries as well, although the majority of the NMS are not following the general EU 15 trend: the share of cash transfers is increasing (Estonia, Slovakia, Latvia, Cyprus); in Poland total social protection benefits are in cash.

The components of cash benefits are, unlike the EU 15, at a high share connected to childbirth and only in Malta and Cyprus is the benefit pattern similar to the EU 15. In the NMS the inheritance of the previous regime in transferring parental vs. childbirth income compensation is still strong (see Figure 2.8).
Social protection benefits in kind for family and children, as compared to the EU 15 (in GDP-PPP per head, EU 15 = 100), seem to be very low in most of the EU 10 countries, with the exception of Hungary and Slovenia. Nevertheless, in-kind benefits in the less developed NMS are significantly underestimated, if they are compared/measured at GDP-PPP total – as already discussed in the previous part of the paper. Thus, although in-kind benefits for children appear to be low, one should not rush to conclusions, considering relative price differences and the increase of expenditure in some countries (Lithuania, Cyprus, Czech Republic) and the only decrease in Slovenia, in comparison to the EU 15.

2.3.4. Some thoughts on targeting social transfers and taxation
Looking at the gross income of poor households with children and social protection transfers, some of the EU 10 countries still have a high share of social benefit transfers, similarly to the European rich welfare states (this holds especially for Hungary but also the Czech Republic, Estonia, Latvia or Slovenia. (Figure 2.9 shows the main sources of income and transfers for poor households with children in the EU countries)
Social indicators provide evidence that protection is needed for the vulnerable groups of youth. Yet, scarce social expenditures are transferred in many of the EU 10 countries without means-testing the target of the transfers, that is, the benefit recipients. Access to healthcare services or unemployment benefit is in most of the countries universal and does not depend on testing the income level of the beneficiaries. Housing benefits, on the other hand, having a minor share in total social protection benefits, are fully in-kind, and are means tested in all EU countries. Directly children and family-targeted social protection benefits are means-tested in some of the EU 10 countries and non means-tested in others. In Cyprus, Slovakia, Latvia, Hungary or Lithuania (mostly cash) benefits are transferred, without, in fact, means-testing the need of the targeted person or household. In other EU 10 member countries, as Malta, Poland, Slovenia or the Czech Republic, on the other hand, a high share of children and family related benefits are means-tested, that is, the benefits are principally targeted for those in need. (Figure 2.10 shows the share of the means tested family and children social protection benefits comparing to the EU 15, the EU 10 countries indicated with ◆.)
Social exclusion protection benefit is small in share and particularly targeted at vulnerable groups at risk. In spite of its target, a considerable share of social exclusion benefits are transferred without means-testing (in Latvia, Hungary, Malta, Cyprus), and only in Poland and Slovakia is a high proportion of social exclusion benefits means tested. In several EU 15 countries, on the other hand, social exclusion benefits are fully means-tested. (Figure 2.11)

The policy outcome is either excessive generosity of transfers of the scarce resources, or overly strict control over benefit transfers. Thus, the EU 10 countries fall into two groups of extreme models, while most of the EU 15 countries are “in-between”, with respect to the share of means-tested benefits. (see Figure 2.12) The EU 10 countries should move towards the model characterising the majority of the EU 15. Means-testing is principally based on a fair process and justifies the aim of the means test to select those beneficiaries who are in need for the benefit. Nevertheless, discussions on means-testing are facing the issues of difficulties of a fair and transparent procedure.
The redistribution effect of social benefits can be either matched or contrasted by the tax system. Brewer et al (2008) makes clear that having to desirable features of a tax and benefit system that it be fair and that it minimise disincentive effects of taxing one has to know how much weight to give to each. “For example, a poll tax (under which all individuals have to pay the same level of tax) might have no disincentive effects, but is rather unfair to those on low incomes. … objective of the government when designing the tax and benefit system should be to maximise social welfare (subject to a need to raise a certain amount of revenue). Precisely how social welfare is expressed is not relevant at this stage, but the idea is that it reflects in a single index (or number) the desire both to have the economy as large as possible (because this directly increases people's well-being) but also to have the income distributed as equally as possible. The expression for social welfare precisely quantifies the trade-off between these two desiderata: returning to the previous example of an economy with only a poll-tax, replacing that with an income tax which raised the same amount of money would give a more equal distribution of income, but - if there any disincentive effects to taxation - a smaller economy. The normative analysis is crucial for policy-making, because it shows how taxes and benefits should be designed in order to best reach the policy goals. … The normative analysis makes it explicit that one cannot hope to say how best to design taxes and transfers without both knowing how individuals will respond, and without specifying what one is trying to achieve overall.” (Brewer 2008, pp 4-5).

Countries differ considerably by the distinct roles of the transfer and tax systems. Tax concessions can act like transfers, increasing the net allocation to children. In contrast, the tax system can reduce the gross effect of transfers if they are taxable. Countries differ a lot by characteristics of tax and benefit regime; both effects are present in national systems: the effect of the components of transfers and tax concessions. In the EU 15 Spain and at a lesser extent Italy rely on tax concessions while the Nordic countries on transfers, and still others on a mix of both, while the majority of the benefits are transfers. (Data on child contingent net transfers and tax concessions in EU15 for 2001 are given in Annex 1 Figure A1.6. No similar data for the EU 10 are calculated yet.)

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26 Taxes and benefits are sensitive to political debates and they are often confusing. Left oriented politicians and experts argue for redistributive effect of benefits and reluctant to support high tax rates. Conservative right oriented policy-makers, on the other hand, argue against redistributive resources and eminently against high taxes as a source for redistribution. (Brewer et al, 2008)
Tax concessions are strongly related to the set of measures characteristic of, and historically routed in, a particular national system. Report on the Spanish reform shows that the tax-benefit expenditure on children in Spain was low and tax relief was used as the main child-targeted policy. Since this type of policies principally favours better-off households, the Spanish system was particularly deficient at protecting poor children. The recent reform has introduced for the first time a non-income-related benefit in Spain. Since this new benefit was targeted on working mothers with children aged under 3, its coverage was limited and reinforced the apparently regressive distribution of child protection. As a result, after the reform the Spanish child-related policies were less efficient at reducing child poverty and redistributed income towards the better-off children. (Levy 2003) Another extreme case is the example of the UK. Since 1997, an additional means-tested tax credit has been introduced, which is conditional on the presence of children. It came about because of the concern about the high levels of relative child poverty. Overall, child-contingent transfers in the UK are now more means-tested rather than being universal. Because there has been a large increase in entitlements to welfare benefits and tax credits for families with dependent children, but none for those without children, the size of net transfers that is conditional on having children has risen substantially. (Brewer et al, 2008: 35)

Another illuminating example for the contradictory effect of tax reform related to children is the Polish case, where, to reduce the poverty rate of children that was the highest in Europe in 2004, a non-refundable child credit was introduced in 2006 that amounted to around 0.6% of the GDP. It had been supposed that alleviation of the high risk of child poverty can be achieved by higher expenditures. Nevertheless, the general negative relationship between spending and poverty does not necessarily mean that countries with high poverty rates need to spend on the same scale as low-poverty countries to achieve the same low rate (Atkinson, 2000). Levy et al (2008) examine how much child poverty figures could change under several reform scenarios using EUROMOD micro-simulation capacities. They compare the Polish reform with three very different models: the Austrian universal tax system, the French tax concessions that is targeting at large and lone parent families, and the UK’s means-testing system. Supposing the same total expenditures that has been allocated to the Polish reform the model shows that the effect of various models are possible different. The level of expenditure in the bottom three deciles of the income distribution was higher in the case of all three systems than under the conditions of the new Polish Reform. The systems of France and the UK would reduce poverty risk in almost all types of households relative to the new Polish system, and when the poverty figures are aggregated then all three analysed systems prove more effective in lowering child poverty relative to the introduced policies, as they are more precisely targeted on the poorest households relative to the Polish system. In sum, the main result of the study is that the significant amount of resources spent could have brought greater reductions in poverty rates among children had it been channelled differently to households with children and prove that better targeting of social spending explains effectiveness of these policies.

In seeking to improve the well being of children and reduce child poverty, one of the central issues is how much can be achieved through income redistribution through the benefit and tax systems. An important lesson looking at various country experiences is that the general negative relationship between expenditures and poverty does not necessarily mean that countries with high poverty rates need to spend on the same scale as low-poverty countries, to achieve the same low rate of child poverty. In addition, comparing various country experiences we can draw the lesson with Sutherland , „… comparisons tell us little about the most effective structure of social benefits and taxation for reducing poverty in any one national context. Nor do they tell us how to design the most effective reforms to existing
systems. As well as the overall scale of spending, effectiveness depends on many other factors, including the way in which policy is targeted, whether it is conditional on certain activities, and the extent of take-up.” (Sutherland 2001, p. 9)

3. Summary and implications for social policy

In the first part of our study we have shown that the general environment of fiscal policy in EU-countries may indirectly limit the scope of individual governments’ policy decisions with respect to social expenditures. Macroeconomic stability is, rightly, considered as common policy concern within the EU. The achievement of relatively small fiscal deficits is considered to be the major means by which this objective can be accomplished. While there are no explicit requirements regarding the “size” of government, the goal of decreasing deficits, combined with the majority view favouring “smaller government”, involves lower expenditures in general, and a smaller share of social expenditures, in particular. Although this general – institutional and intellectual – environment affects both the older (EU 15) and the new members (EU 10: NMS) of the European Union, is not binding: individual countries, both older and new members, often departed from overall trends. (We should also note that fiscal restrictions and cuts in, or reshaping of social expenditures in some of the NMS may be in conflict with the EU-wide objective of social protection and social inclusion of vulnerable groups in need.)

A further line of our analysis was related to measurement/methodological questions regarding international comparisons of social transfers. We called attention to the fact that for most of the NMS, the actual volume of social transfers in kind is generally understated if these items are converted at the PPP for GDP. There is an opposite problem (overstatement) in the case of comparisons of cash-transfers, but its empirical significance is much less serious.

Among social expenditures in kind, mainly healthcare, and particularly, education effect children. Social protection benefits related to children are social transfers that intend to compensate the social cost and/or reduce the burden of childbearing, and are aimed at children, or at families with children at risk. When comparing trends in these social protection expenditures of the EU 10 and the EU 15, we observe an increase in the EU 15 average and a decrease in the EU 10. However, even after considering the differences in relative prices, the share of social protection benefits in cash is generally increasing in both regions of the EU.

We also considered the question of targeting social expenditures and taxes and found that NMS fall into two groups: in some of them means-testing is almost absent, while in others it is extremely strict. According to the results of the EUROMOD research, which correspond to ours, in the less developed south-European countries there are no universal social benefits for children. In the more developed European, especially Scandinavian, countries, children are supported by several non-means tested benefits. On comparing EU 10 and EU 15 countries, we observed the sharp contrasts referred to above, but we believe that moving towards an “in-between” model characterising most EU 15 countries would be beneficial for the EU 10 as well. This leads us to elaborate on some further issues of social policy. Children related tax concessions or tax credits can act like transfers, increasing the net allocation to children. On the other hand, the tax system can also reduce the gross effect of transfers if they are taxable. In general, cautious targeting, investigation of the influence and redistribution effect of the tax related social transfers is essential.

An important lesson looking at various country experiences is that the general negative relationship between expenditures and poverty does not necessarily mean that countries with high poverty rates need to spend on the same scale as low-poverty countries, to achieve the same low rate of child poverty. Child poverty policy can rely on various sources to increase
incomes: directly through transfers or through more indirect routes. Sutherland (2001) underlines the importance of (1) policies to alter income levels directly through the tax and benefit system to provide direct financial support to families, recognising the extra costs of children; (2) policies to promote paid work to ensure that parents have the help and incentives they need to find work, since paid work is seen as the best long-term route to financial independence for families; (3) measures to tackle long-term social disadvantage of youth.

Beyond compensating for disadvantages, the important task lies in prevention of the reasons leading to disadvantages. In most of the former socialist EU 10 countries this is a particularly important task, given the emergence of long-term unemployment and the low level of labour market participation in general. In these countries, the impact of the unemployment and joblessness of parents on child poverty is especially severe. The low level of unemployment benefits in the EU 10 adds to vulnerability of children of jobless parents. Unemployment and, more generally, the labour market situation of parents is a key determinant of the conditions in which children live and develop. Unemployment or in a wider sense joblessness of parents is the main risk of poverty of the children. Even if parents are employed, insufficient income may result in in-work poverty of the family that is also a risk of poverty for the children. Low-income-jobs and/or welfare jobs, as well as the share of the earners and dependents in the family are important factors of in-work poverty. Employability of those out of the labour market or especially those on the margin of the labour market depends on various in-kind benefits (e.g. child care) as well as on active labour market policies. We can also refer to the heated debates around the effects of social protection benefits regarding their negative incentives for work. In this respect each country should strive at reaching a delicate balance that heavily depends upon country-specific circumstances and former experiences regarding the effects of social transfers.

Finally, and corresponding to our evidence on the Slovak case, Sutherland (2001) underlines the importance of the macroeconomic circumstances. He stresses that “successful welfare-to-work strategies depend on jobs being potentially available. In most welfare systems it is the children of parents without paid work who run the greatest risk of living in poverty. Tax and welfare systems which aim to compensate these children are under most pressure when unemployment is high and the tax base is small. Programmes to tackle long-term disadvantage do not by their nature "deliver" quickly, and must be sustained over a long period. They may be particularly vulnerable to funding cuts when public finances are tight.” (p 5)
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Annex 1: Auxiliary tables and figures

Tables

Table A1.1. Redistribution through cash transfers and household taxes towards people at the bottom of the income ladder, mid-2000s

<table>
<thead>
<tr>
<th>Country</th>
<th>A. Average ratio of household disposable income</th>
<th>B. Share of public transfers paid to lowest quintile (A*B/100)</th>
<th>C. Transfers to lowest quintile (A*B/100)</th>
<th>D. Average ratio of household disposable income</th>
<th>E. Share of taxes paid by lowest quintile</th>
<th>F. Taxes from lowest quintile (D*E/100)</th>
<th>G. Net transfers to lowest quintile (C-F)</th>
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Note: Values in Columns A and D are the ratios of public transfers and household taxes, respectively, in the disposable income of the entire population; Columns B and E show the shares of public transfers and household taxes received and paid, respectively, by people of the bottom quintile of the population. Data refer to the mid-2000s for all countries. The table excludes countries where data on household taxes are not available (i.e. where available data on public transfers are expressed “net” of taxes).

Source: OECD(2008)

Table A1.2. Net lending (+) or net borrowing (-) excluding interest: general government (% of GDP)

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Source: Ameco online database (2008)
Table A1.3. Total expenditure: general government (% of GDP)

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Source: Ameco online database (2008)

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<td>GIC/cap -converted at PPP for GDP(1)</td>
<td>17</td>
<td>17</td>
<td>21</td>
<td>20</td>
<td>22</td>
<td>22</td>
<td>24</td>
</tr>
<tr>
<td></td>
<td>-- converted at PPP for GIC(2)</td>
<td>37</td>
<td>42</td>
<td>45</td>
<td>40</td>
<td>43</td>
<td>46</td>
<td></td>
</tr>
<tr>
<td></td>
<td>GDP/capita(3)</td>
<td>22</td>
<td>26</td>
<td>28</td>
<td>30</td>
<td>31</td>
<td>34</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(2)/(1)-1</td>
<td>118%</td>
<td>-139%</td>
<td>116%</td>
<td>102%</td>
<td>91%</td>
<td>88%</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(2)/(3)-1</td>
<td>64%</td>
<td>-61%</td>
<td>63%</td>
<td>33%</td>
<td>36%</td>
<td>33%</td>
<td></td>
</tr>
</tbody>
</table>

Source: calculations based on Eurostat (2008)
FIGURES

Figure A1.1. External (Pgdp) price ratios (relative to the EU 15) and internal price ratios

i) 4 central-European countries

ii) B3 countries
iii) Cyprus, Malta and Slovenia

iv) Bulgaria and Romania

Source: calculations based on Eurostat (2008)
Figure A1.2. Ratio to (share in) GDP

i) V-5 countries

Nominal

Real

Cash transfers

Transfers in kind

ii) Baltic countries

Nominal

Real

Cash transfers

Transfers in kind

Cash transfers

Transfers in kind

Cash transfers

Transfers in kind
iii) Cyprus and Malta

![Graphs showing per capita real transfers in kind and cash for Cyprus and Malta in relation to EU-15.](image)

Source: calculations based on Eurostat

**Figure A1.3.** Per capita real transfers in kind (left pane) and in cash (right pane) at (relevant) PPP-s in relation to per capita real GDP relative to the EU-15. Cyprus and Malta (upper pane) and Bulgaria and Romania (lower pane).

In kind

![Graphs showing the percentage change in per capita real transfers in kind for Cyprus and Malta in relation to EU-15.](image)

Cash

transfers

Transfers in kind

![Graphs showing the percentage change in per capita real transfers in cash for Cyprus and Malta in relation to EU-15.](image)

Source: calculations based on Eurostat

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27 The figure corresponds to Figure 1.13 in the text
Figure A1.4. Social protection benefits by function, GDP-PPP per head in % of the EU 15

Source: Eurostat database, 2008, social protection expenditure
Figure A1.5. Share of in kind benefits in social protection benefits by function

a) Sickness and healthcare

b) Family & children

c) Unemployment

d) Social exclusion n.e.c.

Source: Eurostat database, 2008, social protection expenditure

Figure A1.6. Child contingent net transfers and tax concessions in EU15
Expenditures per child as a share of per-capita household disposable income in 2001, %

Source: Corak et al (2005) p 20
The main use of purchasing power parities (PPPs) is in the international comparison of volumes (i.e., nominal magnitudes adjusted for differences in the price level) of particular expenditures. The kind of PPP best suited for this purpose is based on the so-called EKS (Éltető-Köves-Szulc) method; these are the ones published by the Eurostat and the OECD on an annual basis. In contrast, PPPs designed for comparing the structure of prices and/or the share of particular expenditures in GDP are obtained by the so-called GK (Geary-Khamis) method. (See the PPP-manual: Eurostat-OECD, 2006.) The latter, however, are available only for the benchmark years 2002 and 2005 (published in Eurostat-OECD, 2005 and 2007) and the results between the two years are not comparable. As we wished to give an idea of the real share of social transfers in kind (government individual consumption, GIC) not just for a single year, but a number of years during the 2000s, we applied EKS PPPs for estimating the share of these expenditures at comparable prices.

Since we are aware that our solution is not the first best one, and it offers only an approximation of real shares, the following three figures are meant to show the effect of our proxy on the results for the year 2005. Figure A3.1 shows three indicators of the price ratio of “government individual consumption” to GDP. The first [Pgic(GK-OECD)] is the “proper” one based on GK-PPP and average OECD prices. The second [Pgic(GK-EU)] is same, but it is normalised so that the relative price for the EU=100. The third [Pgic(GK-EKS)] is normalised in a similar manner, but instead of the “proper” PPP, the EKS PPP is used as a proxy. (We applied the last type of PPP for comparing real shares of GIC in table A1.2) It can be seen that, except for a few countries (Portugal and Slovenia), there is very little difference between the last two indicators.

For closer inspection, Figure A3.2 displays the same three price ratios regarding 7 former socialist NMS, the EU average and, for comparison, a highly developed member of the EU, Denmark. For each country the three estimates for the relative price of GIC are rather close to one another. In all of the new members shown in the figure, GIC is relatively cheap (its relative price is well below 100), regardless of how the relative price is estimated. In Denmark, in contrast, a country with much higher per capita income, GIC is relatively expensive, again irrespective of the type of PPP used for estimating its relative price.
A3.2. Three indicators of the relative price of government individual consumption to GDP in selected EU-countries in 2005 (Price level of GDP=100)

Finally we show the effect of using alternative PPPs on the estimated “real” share of GIC in GDP (see Figure A3.3.)

Figure A3.3. The share of GIC at national prices (“nominal” share), at OECD average prices, and EU average prices (with two types of PPPs) in selected EU countries in 2005

The first bar indicates the share of social transfers in kind (GIC) within GDP at national prices; these are referred to as “nominal” shares. The next three bars show “real” shares, i.e. ratios to GDP at comparable prices. (The latter are obtained by dividing the nominal share in each country by the relative prices in Figure A3.2.) Figure A3.3. clearly shows that in the former socialist NMS the relatively low nominal share of GIC in GDP is primarily due to the low relative price of this item. If its share is estimated at international prices, much higher ratios to GDP are revealed. More importantly, the difference between shares measured at domestic prices on the one hand, and international prices on the other depends only marginally on the method by which shares at international prices are estimated.
ANNEX 3: List of abbreviations and definition of terms

List of abbreviations

B3: Baltic countries (Estonia, Latvia and Lithuania)
CB: cash-benefits (= social transfers in cash by the government)
EU10: countries that joined the EU in 2004: B3 plus V5 countries plus Cyprus and Malta
EU15: countries of the EU that had already been members before the enlargement (by the NMS) in 2004
GIC: government individual consumption (= social transfers in kind by the government) – for details, see definition of terms
HCE: household consumption expenditure (=total household consumption less GIC)
NMS: new member states of the EU (NMS8: B3+V5; NMS10 = NMS8+Cyprus and Malta; NMS12=NMS10+Bulgaria and Romania
NMS(FS)10 (former socialist new members): NMS12 less Cyprus and Malta
Per capita income: GDP per capita, calculated at purchasing power parity (PPP)
PPP: purchasing power parity (see definition of terms and BOX 1 in the text)
PPS: purchasing power standard (see definition of terms)
RPc: external relative price (the ratio of the PPP of a particular component of GDP to the official/market exchange rate. Thus, the external relative price of the GDP (the “general” relative price level) of a particular country is defined as the ratio of PPP for GDP to the exchange rate. (Eurostat refers to this indicator as “Price level index”.)
RPI: internal relative price (the ratio of the external relative price of two particular components of the GDP)
V5: Visegrád countries (the Czech Republic, Hungary, Poland, Slovakia and Slovenia)
V4: V5 less Slovenia

Definition of terms

Government individual social expenditures = social transfers in kind by the government (ESA 95; 3.8.1.):
By convention, all government final consumption expenditure under each of the following headings should be treated as expenditures on individual consumption:

(a) 7.1 Medical products, appliances and equipment
    7.2 Outpatient services
    7.3 Hospital services
    7.4 Public health services
(b) 8.1 Recreational and sporting services
    8.2 Cultural services
(c) 9.1 Pre-primary and primary education
    9.2 Secondary education
    9.3 Post-secondary non-tertiary education
    9.4 Tertiary education
    9.5 Education not definable by level
    9.6 Subsidiary services to education
(d) 10.1 Sickness and disability
    10.2 Old age
    10.3 Survivors
    10.4 Family and children
    10.5 Unemployment
    10.6 Housing
    10.7 Social exclusion n.e.c.

Social transfers in kind
Alternatively individual consumption expenditure of general government corresponds to division 14 of the COICOP, which includes the following groups:
14.1 Housing (equivalent to COFOG group 10.6)
14.2 Health (equivalent to COFOG groups 7.1 to 7.4)
14.3 Recreation and culture (equivalent to COFOG groups 8.1 and 8.2)
14.4 Education (equivalent to COFOG groups 9.1 to 9.6)
14.5 Social protection (equivalent to COFOG groups 10.1 to 10.5 and group 10.7).

Purchasing power parity (PPP)
PPPs are indicators of price level differences across countries. PPPs tell us how many currency units a given quantity of goods and services costs in different countries. The main use of PPPs is to convert national accounts aggregates, like the Gross Domestic Product (GDP) of different countries, into comparable, real aggregates. Applying nominal exchange rates in this process would mean that countries with high price levels would have their GDP overvalued relative to countries with low price levels. The use of PPPs ensures that the GDP of all countries is valued at a uniform price level and thus reflects only differences in the actual volume of the economy. (See Eurostat database, 2008)

In other words, PPP is a ratio of national price levels (i.e. a cross-country price index relative to a particular country – generally the US – or to the average of a group of countries (e.g. the EU-average – see PPS). The PPP for GDP may be interpreted as representing the general price index in spatial comparisons. However, as pointed out in the text, the PPP is not a single number: different PPPs apply for different components of GDP.

Purchasing power standard (PPS). The name given by Eurostat to the artificial currency unit in which the PPPs and real final expenditures for the EU 25 are expressed – namely, “euros based on the EU 25”. “Euros based on the EU 25” are euros that have the same purchasing power over the whole of the EU 25. Their purchasing power is a weighted average of the purchasing power of the national currencies of EU Member States. As such, they reflect the average price level in the EU 25 or, more precisely, the weighted average of the price levels of Member States. (Eurostat-OECD, 2006) [After the latest enlargement, PPS refers to the price level of individual member states relative to the price level of the EU 27.]

Social protection benefits
Defined in the ESSPROS Manual 1996 and used in data collection:
(Data on social protection expenditures provide data on social protection financial flows, but the efficiency of using the expenditures are not measured. Data are based on national administrative sources)

Overall social protection benefits and those related to family and children
- Social protection expenditure
  - Social benefits
    - Non Means-tested
      - Cash benefits
        - Periodic
        - Lump sum
    - Benefits in kind
  - Means-tested
    - Cash benefits
      - Periodic
      - Lump sum
    - Benefits in kind
Detailed breakdown of social protection benefits for the function: Family / Children

Social protection benefits

- Non Means-tested
  - Cash benefits
    - Periodic
      - Income maintenance in the event of childbirth
      - Parental leave benefit
      - Family or child allowance
      - Other cash periodic benefits
    - Lump sum
      - Birth grant
      - Parental leave benefit
      - Other cash lump sum benefits
  - Benefits in kind
    - Child day care
    - Accommodation
    - Home help
    - Other benefits in kind
- Means-tested
  - Cash benefits
  - Benefits in kind

Means-tested benefits or allowances (e.g. child benefits or family allowances) tend to decrease when the income of beneficiary increases.

Child-related tax concessions are complements to cash benefits through reducing the tax of income of the parents.

Tax credits refer to tax treated as deducted at source, which has not actually been deducted or paid. Tax credit is generally more effective than tax deduction or tax allowance of the same magnitude because a tax credit reduces tax directly while tax deduction or allowance only reduces taxable income and so the reduction in tax is only a part of the deduction or allowance.

Non-wastable tax credit is not dependent on the final tax liability of households in terms of the amount received and which is, therefore, equivalent to cash benefits in its effect.