BETTER POLICIES FOR BETTER LIVES

Private social expenditure and the influence of tax systems

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Key findings

- Private social spending – mainly health insurance and pensions -- is worth about 3.1% of GDP, on average in the OECD; it comes in addition to public social spending which amounts to about 21% on average (OECD, 2023[1]).
- At around 12-13% of GDP, private social spending was highest in the Netherlands and the United States in 2019.
- Mandatory private social spending accounted for about 6% of GDP in Iceland (pension, survivors and incapacity benefits), the Netherlands (health insurance), and the United States (health insurance – "Obamacare"). It is largest in Switzerland at over 10% - health and (survivor) pensions - but this amount includes some voluntary pension spending that cannot be separately identified.
- Private pensions are the main item of voluntary private social expenditure which amounts to 5 to 6% of GDP in Canada, the Netherlands, the United Kingdom and the United States.
- The effect of tax systems on social expenditure is considerable:
  - In 2019, the amount of benefit income clawed back through direct and indirect taxation was highest at 7.6% of GDP in Denmark and exceeded 5% of GDP in Austria, Finland, France, Greece, Italy, the Netherlands, Norway and Sweden.
  - Those tax breaks with a social purpose (TBSPs) which are similar to cash benefits were close to 1% of GDP in France, Germany, Hungary, Korea, the Netherlands and Türkiye; and amounted to 1.3% in Portugal. TBSPs that can be seen as replacing cash benefits to *households* often involve tax credits towards dependent children.
  - TBSPs to stimulate provision of "current" private social benefits (often health-related) were largest in the United States at just under 2% of GDP. These TBSPs include tax relief for non-commercial non-government organisations that provide social support and tax advantages for employers and/or individuals towards private health insurance contributions.
- Accounting for private social expenditure and the impact of the tax system gives a total for social expenditure in a country. France is the biggest social spender at over 30% of GDP (it is also the country with most public social spending). The United States spends second most, at just below 30% of GDP, despite having one of the lowest levels of public social expenditure.

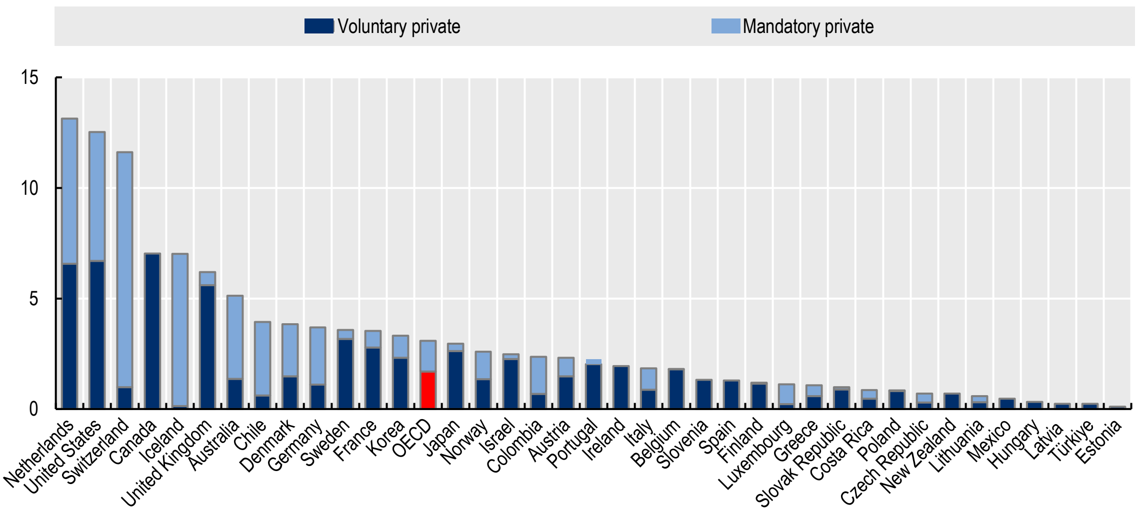
Public social expenditure amounted to about 21% of GDP on average across the OECD in 2022 (Public social expenditure is discussed in the "twin-statistics brief": The rise and fall of public social spending with the COVID-19 pandemic"). However, most countries also have private social programmes that deliver social support. The distinction between public and private social expenditure is based on who controls the relevant financial flows; public institutions (different levels of government and social security funds) or private bodies (non-government organisations (NGOs), including charities, employers and private health and pension funds (OECD, 2019[2]). All social benefits not provided by public institutions as defined above are 'private'. The extent to which private bodies deliver social support varies across countries but on average across the OECD, it amounted to 3.1% GDP in 2019.

Private social expenditure

Private social expenditure concerns social benefits delivered through the private sector (not including transfers between individuals) which involve an element of compulsion and/or inter-personal redistribution, for example through pooling contributions and risk sharing to cover health and longevity risks, or fiscal support for taking out social protection coverage, e.g. a pension plan, such as an Individual Retirement Account in the United States (OECD, 2019[2]). Private social expenditure can be mandatory (stipulated by law) or voluntary. Mandatory private social expenditure includes compulsory private health insurance schemes, pension benefits based on compulsory contributions, or sickness payments to employees by employers. Voluntary private social expenditure includes pension benefits based on past voluntary contributions, employer-provided childcare support, or benefits provided by charitable non-government organisations (NGOs). In 2019, private social spending totalled, on average, about 3.1% of GDP across the OECD, of which 1.4 percentage points was mandatory and 1.7 percentage points voluntary. Private social expenditure was largest in the Netherlands (13.1% of GDP in 2019), the United States (12.5%) and Switzerland (11.6%); it amounted to 5 to 7% of GDP in Australia, Canada, Iceland and the United Kingdom (Figure 1).

Figure 1. Private social spending is largest in the Netherlands, Switzerland and the United States

Private social expenditure by type, as % GDP in 2019



Note: The amount of mandatory private spending in Switzerland includes private (survivor) pension benefits worth, 5.3% of GDP in 2019. These pension payments accrue from both mandatory and voluntary private pension contributions in the past, but their share is not separately identifiable.
Source: OECD (2023) OECD Social Expenditure database (www.oecd.org/social/expenditure.htm).

Mandatory private social expenditure

Mandatory private health expenditure is most important in Iceland, the Netherlands, Switzerland, and the United States. In Iceland, mandatory private benefits are mostly cash benefits paid as (survivor) pensions and incapacity benefits. By contrast, in the Netherlands and Switzerland, mandatory private health insurance has long been important. Mandatory health insurance in the United States received additional impetus (some states have long had workers' compensation legislation that includes the provision of medical benefits by private funds) with the introduction of the Affordable Care Act in 2014. This mandated a significant part of already existing employer-provided health plans, voluntary private health spending in the United States declined with its introduction from 6.2% of GDP in 2013 to around 1% in 2019.

Mandatory private cash benefits often concern pension payments that accrue from past mandatory contributions, and such spending amounted to 3.6% of GDP in Australia (Superannuation) and over 4% of GDP in Iceland and Switzerland (see the note to Figure 1). Occupational injury and accident legislations can provide for cash benefits to claimants, while countries sometimes also oblige employers to continue wage payments (at least in part) to employees who are absent form work because of illness. Such mandatory incapacity benefits amounted to 1% of GDP or more in Germany, the Netherlands and Norway and were highest at 2.4% of GDP in Iceland.

Voluntary private social expenditure

Voluntary private pension spending often concerns collective (often employment-related) health insurance plans or pension payments based on past voluntary contributions to pension plans. Private pension provision can be an important part of national social protection systems. Pension payments based on occupational and industry-wide programmes, or tax-supported collective or individual plans amounted to between 4 and 6% of GDP in Canada, the Netherlands, the United Kingdom and the United States.

Individual out-of-pocket spending on health services is not regarded as social spending, but many private collective health insurance plans across the OECD involve pooling of contributions and risk sharing across the insured population. On average across the OECD, such private social health expenditure amounted to 0.5% of GDP in 2019 and was largest in Australia and Canada at around 1.5% of GDP.

Private social spending also includes social services and benefits provided by non-government organisations (NGOs) to those most in need, but as such outlays are often not centrally recorded, this type of spending is under-reported in SOCX.

The impact of tax systems on social spending levels

Tax systems can affect public and private social spending in different ways (public social expenditure is discussed in the "twin-statistics brief": The rise and fall of public social spending with the COVID-19 pandemic"):

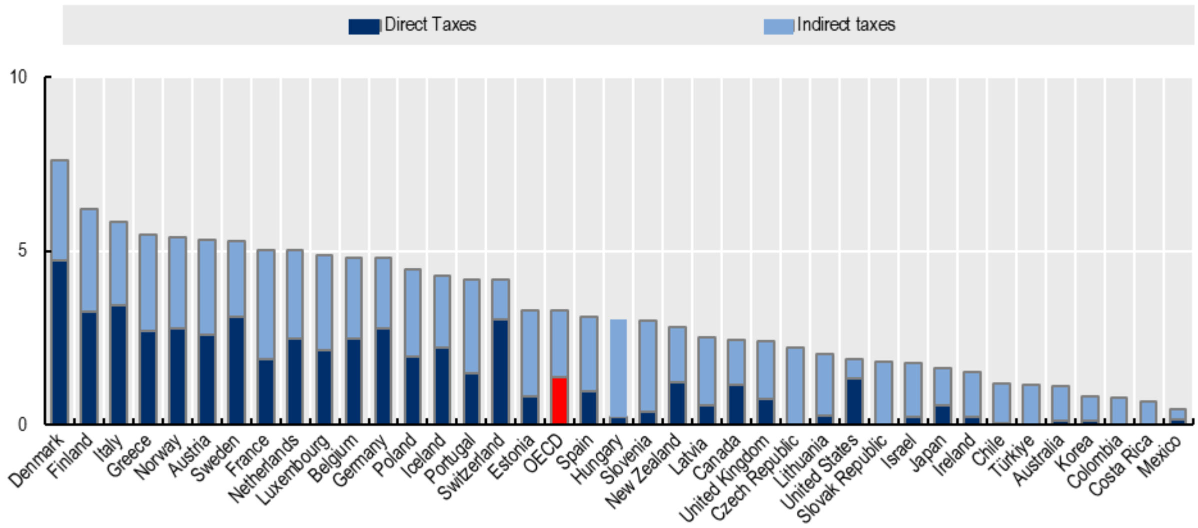
- Governments can levy direct income tax and social security contributions on cash transfers to beneficiaries, thereby clawing back part of the initial benefit payment. In 2019, direct tax levied by the Danish Government over benefit payments amounted to almost 5% of GDP, while this was only about 1.4% of GDP across the OECD on average (Figure 2).
- Governments can levy indirect taxation on consumption out of benefit income. On average across the OECD, this was worth almost 2% of GDP in 2019. Tax rates on consumption are often considerably lower in non-European OECD countries where tax revenue on consumption out of benefit income often amounted to less than 1% of GDP (Figure 2). In Europe, such tax revenue is close to 3% of GDP in Austria, Denmark, Finland, France, Greece, Hungary, Luxembourg, Norway, Portugal and Slovenia.
- Governments can also use so-called "tax breaks with a social purpose" (TBSPs) to directly provide social support or with the aim to stimulate the private provision of social support.
    - TBSPs which directly provide support to households and that can be seen as replacing cash benefits. In other words the tax system is being used to deliver financial support directly to households. Often such TBSPs concern support for families with dependent children, e.g., child tax allowances or child tax credits. Figure 3 shows that TBSPs similar to cash benefits in 2019 were close to 1% of GDP in France, Germany, Hungary, Korea, the Netherlands and Türkiye; and at 1.3% in Portugal (child, health care and disability-related tax credit).
    - TBSPs can also be used to encourage institutions to provide social support, or stimulate employers and/or individuals to organise private insurance for their employees or themselves. The provision of "current" private social benefits is the largest in the United States at just under 2% of GDP (Figure 3), of which more than 50% concerns exclusion of employer contributions of medical insurance contributions.

Tax systems often also encourage take-up of private pension coverage. However, favourable fiscal treatment of pensions can affect, the payment of contributions, the investment income generated with pension savings and the pay-out of pensions, and there is no international agreement on how to calculate the value of fiscal advantages at these three stages of pension saving on a cross-national basis. Hence the data presented here do not include estimates on the value of TBSPs to pensions.

Detailed information on the impact of the tax system on social expenditure by country can be found online.

Figure 2. The claw-back of benefit payments through taxation is considerable in Nordic countries

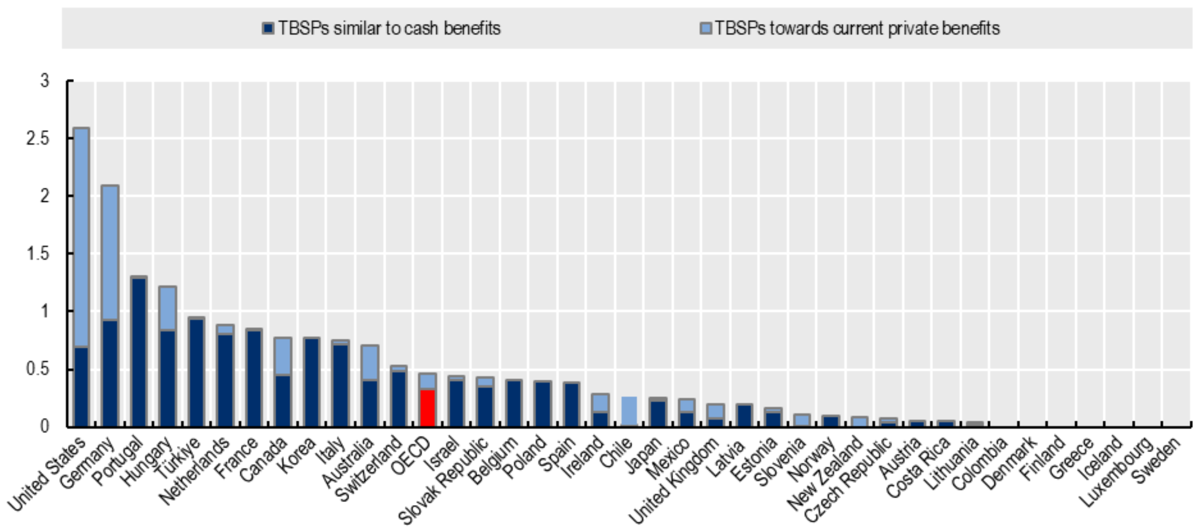
Direct and indirect taxes paid by recipients of public/private benefits, as % GDP in 2019



Source: OECD (2023) OECD Social Expenditure database (www.oecd.org/social/expenditure.htm).

Figure 3. Germany and the United States make extensive use of the tax system to deliver and incentivise social support

Revenue foregone on Tax breaks with a social purpose (not including TBSPs to pensions), as % GDP in 2019

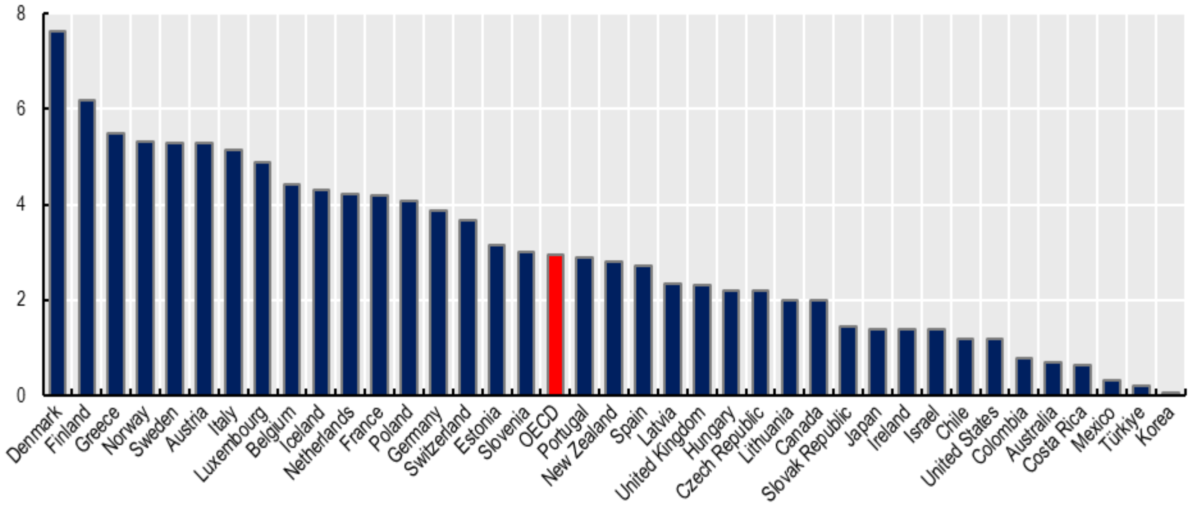


Source: OECD (2023) OECD Social Expenditure database (www.oecd.org/social/expenditure.htm).

The “net tax effect” accounts for these different tax effects in one indicator, by measuring the clawback through direct and indirect taxation over (consumption of) benefit income - minus the value of TBSPs that are similar to cash benefits (see the notes to Figure 4). The value of benefit income clawed back through direct and indirect taxation exceeds the value of TBSPs similar to cash benefits in all OECD countries, particularly in Europe. The “net tax effect” was 5% of GDP or more in Austria, Finland, Greece, Italy, Norway and Sweden and highest at 7.6% of GDP in 2019 in Denmark (Figure 4). The value of TBSPs is generally negligible in these countries so that the next tax effect equals the claw back (again, TBSPs measured here do not include TBSPs towards pensions, see (OECD, 2019[2])). The “net tax effect” is smallest in Korea, Mexico and Türkiye at below 0.5% of GDP. The net tax effect in the United States is positive at 1.2% of GDP, but if TBSPs towards private social programmes were included (1.9% of GDP), the United States is the only OECD country where the value of TBSPs (2.6% of GDP in all) exceeds the tax claw-back over benefit income.

Figure 4. The impact of the tax system on social protection is large in many countries but nowhere more so than in Denmark

Net tax effect, as % GDP in 2019



Notes For Iceland, 2019 tax data were estimated based on available 2015 tax data.
- The "Net tax effect" includes direct taxes and social contributions, indirect taxes and net tax breaks for social purpose similar to cash benefits (TBSPs). TBSPs can also include favourable tax treatment of household pension saving, tax relief for employers and private funds that ultimately benefit households e.g., favourable tax treatment of employer-benefits provided to households, favourable tax treatment of private funds. The value of these is not reflected in this figure, as this item is equivalent to financing of private social benefits and needs to be excluded to avoid double counting when calculating total net (public and private) social spending. For most countries this would not matter as amounts are relatively small, except for the United States where the value of such TBSPs exceeds the tax claw-back over benefit income.
- Because of the complexities with calculating the value of tax reliefs for pension that are given at various stages (e.g., including tax exemptions for contributions to private pensions and tax relief for investment income of capitalised pension funds) there is no fully comparable cross-national data set available on TBSPs for pensions. Hence, available data are not included in the overall calculation of net total social spending.
Source: OECD (2023) OECD Social Expenditure database (www.oecd.org/social/expenditure.htm).

Cross-country rankings

Taking together public and private social expenditure - and accounting for the net tax effect on social spending, facilitates considering a comparison of gross (before tax) social spending and net (after tax) total (public + private) social expenditure (public social expenditure is discussed in the “twin-statistics brief”: The rise and fall of public social spending with the COVID-19 pandemic”). In many ways, the latter provides a more comprehensive view of social spending as it captures the use of private social arrangements and the tax claw-back over benefit income. After all, to reach a similar level of net social support for benefit recipients, gross public spending can be lower in any given country if policy can rely on private coverage of health and pensions to prop up public support. In a similar vein, a country with relatively low gross spending levels can reach the same level of support for benefit recipients as high-spending and high-claw-back countries, if the net tax effect is small or negligible.

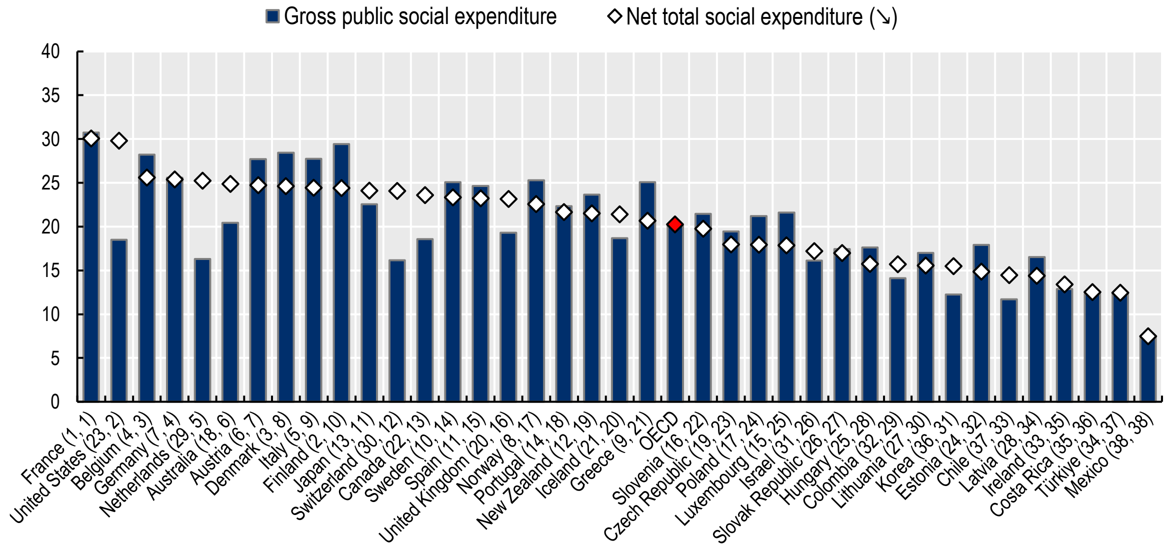
Indeed, countries' use of private social support (e.g., the important role of private pensions in many English-speaking countries) and use of the tax system to provide social support in (e.g., absent in Nordic countries) varies. Considering both public and private social spending and the impact of tax systems on social spending results in a very different cross-national ranking of countries in spending terms than the usual comparison based on gross public spending alone (Figure 5).

That said, France is the biggest social spender according to both gross public and net total social expenditure indicators. This is because private spending and the net tax effect are moderate in international comparison: France ranks just outside the top 10 of countries in terms of private social expenditure and the net tax effect. But for other countries the rankings change significantly. For example, because of a relatively large "net tax effect" (reducing gross spending by 5% of GDP or more) and the limited role of private social spending (1% of GDP), Greece and Luxembourg move down significantly (10 places or more) the rankings when moving from gross to net total social expenditure indicators. The "net tax effect" is also considerable in the Netherlands and Switzerland, but this is more than compensated by the size of private social expenditure in these countries. As a result, they move up the rankings by 18 places or more when considering net total social expenditure.

The combination of small "net tax effects" and considerable private social spending ensures that Australia, Canada and the United States move up the international net total social spending ladder. Private social spending (including health and pensions) is much larger in the United States than in most other countries, and its inclusion moves the United States from 23rd in the ranking of the gross public social spending to 2nd place in the international comparison of net total social spending.

Figure 5. After France, the United States is the biggest social spender when accounting for private social benefits and the impact of the tax system

From gross public to total net social spending, as % GDP in 2019



Note: See the notes to Figure 4.
The numbers in brackets refers to the ranking of countries in term of gross public and net total social expenditure from number 1 being the highest spender to the lowest, e.g., the United States ranks 23 in OECD in term of gross public social expenditure and 2nd in term of net total social expenditure.
Source: OECD (2023) OECD Social Expenditure database (www.oecd.org/social/expenditure.htm).

However, more social spending through private bodies and fiscal arrangements that generate greater cross-national egality in spending levels, does not necessarily mean more redistribution and solidarity. Tax advantages often benefit the well-to-do more than those on low-incomes (certainly when tax breaks are not paid in cash to those with limited or no tax liabilities) and often low-income workers do not have access to private social benefits (Adema, Fron and Ladaique, 2014[3]). A higher ranking in total net social spending does not necessary contribute to more equal outcomes.

Box 1. What is in the OECD Social Expenditure Database (SOCX)?

The new release of the OECD Social Expenditure Database (SOCX) includes detailed social expenditure programme data for 1980-2019/21 for 38 OECD countries. SOCX presents public and private benefits with a social purpose grouped along the following policy areas: old age, survivors, incapacity-related benefits, health, family, active labour market programmes, unemployment, housing and other social policy areas. SOCX includes public spending on early childhood education and care up for children under age 6, but SOCX does not include public spending on education beyond that age. SOCX includes indicators on aggregate public social spending for 2020-22 based on national aggregates where data is available and estimates otherwise. For EU countries, data for 2020/21-22 were estimated on basis of the OECD Economic Outlook Projections and the European Union's Annual Macro-economic database (AMECO), DG ECFIN, as in November 2022. For the United Kingdom, data for 2021 were estimated on basis of OECD Economic Outlook 112 (November 2022) and National Accounts Blue Book 2022. SOCX also includes indicators on net (after tax) social expenditure for 38 countries for 2019 (information on taxation of benefits often does not become available until two years after the fiscal year it concerns). Time series for most countries are available since 2001. Relevant fiscal detail involves direct taxation of benefit income, indirect taxation of consumption out-of-benefit income, and tax breaks with a social purpose.

Data for 25 European countries were provided by Eurostat as based on the information in their European system of integrated social protection (ESSPROS), while information for other countries is provided by national correspondents. Data on health and active labour market programmes were taken from OECD Health Data and the OECD/Eurostat Database on Labour Market Policies. Information on the direct taxation of benefit income and tax breaks with a social purpose was provided by the delegates to the Committee on Fiscal Affair's Working Party No. 2 on Tax Policy Analysis and Tax Statistics.

It should be borne in mind that the quality of data on the effect of tax systems (frequently estimates based on tax models), and private and social spending and spending by local government (because of under-reporting), is not as high as the quality of information on budgetary allocations towards social purposes. For more detail regarding the sources and methodology underlying SOCX and its indicators on social spending, see the OECD 2019 Manual to the OECD Social Expenditure Database (SOCX) at www.oecd.org/social/expenditure.htm.

References

Adema, W., P. Fron and M. Ladaique (2014), "How much do OECD countries spend on social protection and how redistributive are their tax/benefit systems?", *International Social Security Review*, Vol. 67/1, https://doi.org/10.1111/issr.12028. [3]

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OECD (2019), *OECD SOCX Manual 2019 Edition: A guide to the OECD Social Expenditure Database*, https://www.oecd.org/social/soc/SOCX_Manuel_2019.pdf. [2]

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The "twin-statistics brief": The rise and fall of public social spending with the COVID-19 pandemic" discusses public social expenditure.

Notes

Throughout this document, (↗) (or ↘) in the legend relates to the variable for which countries are ranked from left to right in increasing (or decreasing) order.
OECD in figures refers to unweighted average of OECD countries for which data are available.

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