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Fiscal welfare in Europe: a state of the art

(Nouvelle version)

Nathalie Morel, Chloé Touzet, Michaël Zemmour

Abstract

Engaging with fiscal welfare leads to a reassessment of existing understandings of welfare state trajectories in Europe, with regard to their political, institutional or distributional dimensions. Therefore, it is a necessary exercise. Yet most of the recent literature on social tax expenditures focuses on the US, and both literature and data on European cases are sparse. The present article reviews the various concepts used to operationalize the analysis of fiscal welfare and argues that the "Social Tax Expenditures" concept is best adapted to the exercise of measuring the size and defining the properties of fiscal welfare. It presents the data currently available, demonstrates its limits, and identifies pressing gaps in terms of data generation in the field. Finally, based on a survey of the emerging literature on the topic, it presents the potential drivers and effects of the use of Social Tax Expenditures, some of them specific to the European context.

Keywords: Social tax expenditures, Fiscal welfare, Fiscal welfare reform, incentives, hidden welfare state

I. Introduction

In 1958, British scholar Richard Titmuss highlighted what he termed the ‘social division of welfare’, distinguishing between three sources of welfare: *social, occupational* and *fiscal* welfare. He noted that most scholarship on the welfare state restricted itself to the world of social welfare, that is the direct public provision of welfare, failing to note the growing scale and distributive tendencies of occupational and fiscal systems – and the ways in which they often ran counter to the distributive directions of the social welfare system. While US scholars have highlighted the importance of tax expenditures in the American welfare state, in Europe the importance and role of fiscal welfare still remains a blind spot in the welfare state literature, despite the growing acknowledgement of the significant use of social tax expenditures, notably through OECD research conducted in the last 20 years.

Indeed, fiscal welfare is no longer an attribute of the liberal welfare states alone (Esping-Andersen, 1990). It also contributes to organising the household services and care markets in various Nordic or Continental countries; it is a key driver of the development of private pension and health insurance in France; it played a key role in “making work pay” policies in various countries. This development of fiscal welfare across a range of welfare regimes needs to be taken into account, to obtain a better descriptive picture of welfare states’distributive outcomes, and to understand changes in the politics, the governance, and the institutional architecture of specific national welfare arrangements.

To do so, however, certain prerequisites need to be met: a stabilized and comparable concept is necessary to empirically operationalize the notion of fiscal welfare; a comprehensive description of existing schemes, as well as comparable quantitative data, are also needed. Eventually, analysing European fiscal welfare implies to partially depart from the lens used in analysing fiscal welfare in the last twenty years (as this was mainly done in the very specific US context[1]), and to develop an analytical framework adapted to the European cases.

This article aims to tackle these three challenges, opening the 'black box' of European fiscal welfare, by providing a state of the art of the existing literature (mainly US-based, but also including the sparse European literature), and by highlighting the limitations of the existing scholarship on the uses and impacts of fiscal welfare in Europe. In doing so, this state of the art opens up an agenda for further research. Specifically, three questions are addressed in each of the three parts of this article. First, we inquire into the state of the conceptual discussion on fiscal welfare and look for the most relevant concepts to use, from a political economy of the welfare state perspective. Second, we ask what data on social tax expenditures in Europe is available, and what methodological issues need tackling in this regard. Finally, we ask what is known about the uses of fiscal welfare in Europe.

II. Setting the conceptual scene: what are "fiscal welfare" and "social tax expenditures"?

The concept of **fiscal welfare**, defined as the state's use of the tax system in order to provide subsidies for social purposes, was developed by Titmuss (1958) as part of his theory of the "social division of welfare" (SDW). This theory argued that, contrary to the commonly held assumption, middle and higher income earners substantively benefit from the welfare state, which does not merely transfer from rich to poor. This common misrepresentation stems from a truncated understanding of welfare. For Titmuss, a comprehensive definition of the welfare state should not be reduced to social welfare (direct public transfers and services) but should include "all collective interventions to meet certain

[1] Thus, one of the most striking results of the literature on the US case is that taking social tax expenditures into account there shows that the Federal state is much more interventionist in the social policy field than suggested by figures on direct social expenditures. We cannot expect this to be the most important part of the diagnosis in the European case.

needs of the individual and/or to serve the wider interests of society (Titmuss, 1958:42). It thus encompasses three major categories: social welfare, occupational welfare, and fiscal welfare.

While the conceptualization of Titmuss remains relevant to expose the general phenomenon of SDW, it does not provide any tools to operationalize it in the same way that we do for social welfare (especially to identify and quantify its component). In the literature engaging with this topic, several different and partly overlapping concepts have spread. In the present section we map the relation between these categories.

The scholarship on fiscal welfare includes, e.g., the study of tax breaks for mortgages (Ervik, 2000), income deduction for insurance premium, tax-free child allowances, reduced taxation for the elderly, or tax cuts subsidizing occupational benefits (see e.g. Greve 1994, Kvist and Sinfield 1996). Scholars in the SDW tradition (e.g. Sinfield 1978, 1989, Rose 1981, Abramovitz 1983, Mann 1991, 2009) analyse the division of welfare in the light of prevailing social divisions based on occupation, or gender, and establish a "close correspondence between class, power, and the SDW" (Mann, 1991:11): while means-tested social welfare goes to the least well-off, fiscal welfare is welfare for the rich (see e.g. Sinfield 1991, 1997, Orton and Davies, 2009).

The realization that the well-off benefited disproportionately from provisions of the US tax code is also what led tax scholars to draw attention to "**tax expenditures**" (TEs) in the late 1960s. TEs were defined as "departures from the normal tax structure (…) designed to favour a particular industry, activity or class of persons [in the form of] permanent exclusion from income, deductions, deferrals from tax liabilities, credits against tax, or special rates" equivalent to "government spending for favoured activities or groups" (Surrey and McDaniel, 1985:3).

Despite facing numerous criticisms at first[2], the concept spread, both in academic and administrative circles, in the US (Surrey 1979, Toder

[2] Bittker (1969, 1973) prominently criticized the notion as based on a biased definition of income; Le Pan (1979) highlighted the inevitable role of value judgement in defining a "normal" baseline tax structure (see

2000) as well as in other national contexts (Owens 1983, Surrey and McDaniel 1985[3]). Most OECD countries now publish yearly lists of their main **tax expenditures**. TEs are not necessarily fulfilling a social policy purpose; they constitute an object larger than social **tax expenditures** (STEs). STEs have been defined as "social spending delivered as tax breaks" (Stebbing and Spies-Butcher, 2010:586); they can be conceived of as an operationalization of fiscal welfare, or the general set of tax expenditures (departures from the fiscal norm) that contribute to social policy[4] .

A neighbouring concept is that of the OECD's "**tax breaks for social purpose**", or TBSPs (Adema, 1997:154; see also, 2011, 2014). TBSPs are benefits granted through the tax system. They can perform "the same policy function as transfer payments which, if they existed, would be classified as social expenditures" (this is the case, for instance, of tax credits for families); they can also aim "at stimulating the private provision of benefits" – e.g., tax cuts for private health insurance (Adema et al, 2011:29).

Finally, US scholars have developed the concept of "**hidden welfare state**" to describe the role of "indirect tools of social policy such as loans, loan guarantees, and tax expenditures" (Howard, 1997:5) in the American welfare state, typically in sectors like pensions, occupational health insurance, housing, health care, childcare, employment or income support. This "constellation of more indirect or 'hidden' government interventions" (Hacker, 2002:12) was perceived as a blind spot in

also Shaviro, 2003); Wildavsky (1985:414) criticized the concept for attributing default ownership of all individual income to the state. Kleinbard (2008) argued that TE analysis was often "a thinly veiled agenda for a specific form of tax reform", with the "normal tax system" being "not simply an analytical tool, but (…) also an aspirational goal of the process" (Kleinbard, 2008:6).

[3] The term has lost its controversial power, and is also now routinely included in taxation textbooks (see e.g. Gravelle, 2005).

[4] Toder offers another definition more immediately applied to the US case: "tax expenditures (…) to promote social goals (…) include provisions that promote education, health, housing, retirement security, and income security for low-income families" (Toder, 1999:1).

the US social policy literature[5] (Blank 2009). The US hidden welfare state is described as rather substantial, "38 to 50 percent as large as the visible welfare state" according to Howard (1997).

These various concepts are rarely articulated together, yet we attempt to put them on the same theoretical map. The "hidden welfare state" includes the largest range of tools (i.e. regulation, tax incentives, payments to private organizations and households), limited to the welfare sector; the TE concept is the most encompassing in terms of policy sectors spanned, limited to one type of policy instrument. In this article, we focus on the area of welfare (comprising both social and employment policies), and on a definite set of policy tools, namely tax instruments aiming not to raise revenue but to perform social policy objectives. Thus this article's object of study seems best described by the concepts of STEs and fiscal welfare. Indeed the perimeter of TBSPs, based on discretionary choices at the country level[6] and on additional criteria[7], is too restrictive; some STEs (e.g. some employment policies targeting firms which we consider to be an important part of fiscal welfare) are excluded from it.

Two particular conceptual critiques should be addressed when analysing these types of instruments. Prasad (2011) criticized the tendency to equate TEs and traditional instruments of social policy. Considering revenue foregone in the form of tax expenditures as similar to welfare spending leads to the paradoxical idea that the more tax revenue foregone, the larger the welfare state (Prasad, 2011:254), and thus that the US welfare state and some of the more generous European ones are in fact similar, once the hidden part of the US welfare state is ack-

[5] An insight shared with the work on TBSPs is that traditional social policy instrument "do not exhaust the available strategies for intervention" (Hacker, 2002:11); closely-related concepts include the "divided" (Hacker, 2002), "submerged" (Mettler, 2011), or "delegated" (Morgan and Campbell, 2011) welfare state.

[6] Thus Germany does not report the preferential taxation of families and couples as a TBSP, while France does. Data on TBSPs for the UK only contains a very small portion of expenditures on tax credits, because the largest part (the refundable part paid out to beneficiaries) is counted as a direct expenditure.

[7] See note 11.

nowledged (cf. Alber, 2010). This is problematic, because while "redistribution and collectivization of risk (…) are the primary achievements of the welfare state", it is unclear whether the "hidden welfare state" delivers on them (Prasad, 2011:261). To avoid such pitfalls, Prasad argues that these instruments should not be analysed as part of the "welfare state"[8], but as a form of tax cut.

Yet, in excluding STEs from the realm of welfare, one risks missing the realization that all different income groups in society benefit from some form of state intervention (Titmuss, 1958:52); such artificial divisions risk undermining support for the visible welfare state; Prasad, in contrast, warns that wrongly-assumed equivalences risk concealing"the reprivatization of risks that had previously been met collectively, and the waning of state capacity"(Prasad, 2011:263).

We argue that using the concepts of STEs (when referring to precise policy instruments) and fiscal welfare (for more general references to the phenomenon), is best adapted to research on the political economy of welfare states, and allows avoiding both pitfalls. We situate both concepts in the analytical framework of "the welfare state"; yet, the many ways in which fiscal welfare differs from traditional welfare, as well as how it might affect the latter, are precisely the subject of our analysis.

We exclude from the scope of the present article the discussion on the general tax structure (size, progressivity and predominance of different types of taxation), as well as the level of taxation of social benefits (the claw-back effect). These dimensions are certainly of relevance in order to depict and understand national welfare systems, since they determine the economic, distributive and political properties of a national welfare system. Social tax expenditures, however, are an additional dimension of the analysis, situated at the crossroad between the tax structure and the benefit system.

[8] Indeed, "if we accept the definition of a welfare state as different from the absence of a welfare state because it redistributes and pools risks, then tax preferences that do not do these things do not make the welfare state larger" (Prasad, 2011:263).

III. Where do we find STEs in Europe? An overview of available data

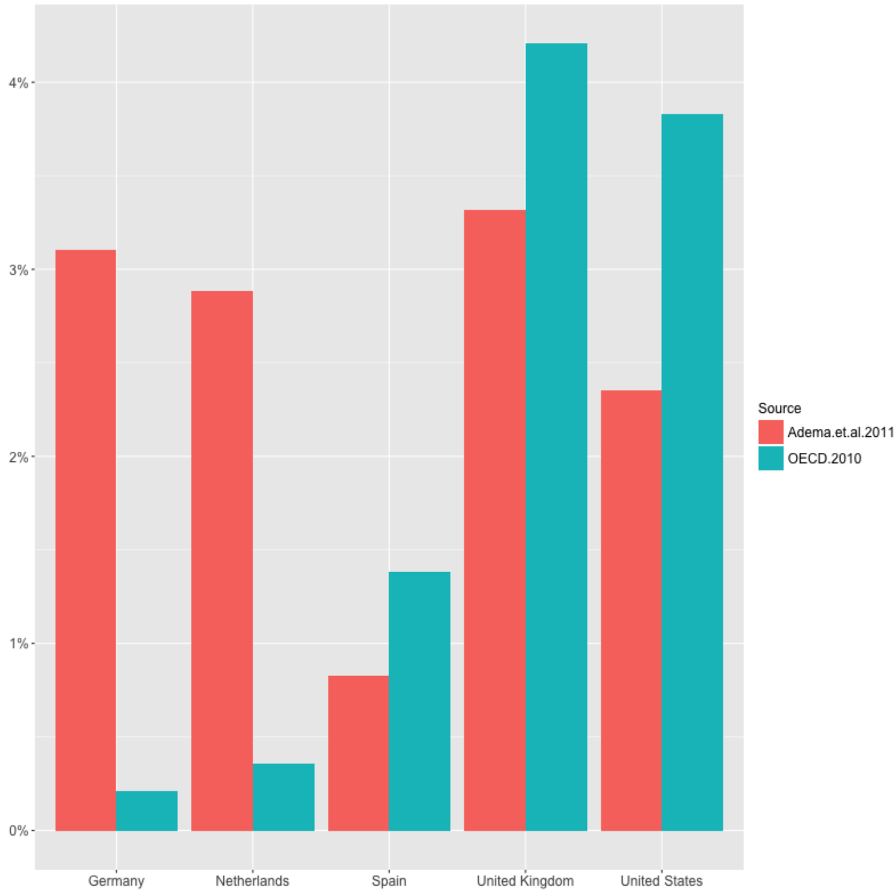
In addition to developing conceptual tools, quantitative measurement of STEs is necessary to analyse fiscal welfare, and in particular to assess their financial and political importance and to draw comparisons over time and across countries. As will be demonstrated below, so far, reasonably comprehensive and comparable data is still missing in most of countries, and even more so at the international level. Here we draw a panorama of available sources and we make some recommendations as to how they should be used; we also highlight directions for future data generation.

The issue of tax expenditures has been increasingly prominent in OECD research since the late 2000s. In 2010, data on tax expenditures in six countries (namely the US, the UK, Spain, the Netherlands, Germany, and Canada) was collected, and harmonized to some extent[9] (OECD, 2010). As far as STEs in particular are concerned, the OECD dataset on Net Social Expenditures (Adema et al., 1997 and following) is the only dataset[10] with comparative, cross-sectorial data on STEs in OECD countries. Since 2001, information is collected every two years through a questionnaire sent to relevant administrations in 33 countries. A simple comparison between these two OECD dataset show dramatic discrepancies, probably due to the lack of stabilized statistics in national administrations, but also to different methodologies used in building the datasets (Figure 1).

[9] The author proceeded to some reclassification, based on prevailing accounting rules in the majority of countries. Yet, most of the limitations highlighted (see infra) concerning the data compiled in Adema et al (2014) apply to the data in OECD (2010) as well.

[10] Since 2011, Eurostat has also started systematically collecting data on STEs in Member States. Yet, this information is not yet available as a single dataset. In addition, Eurostat does not produce its own estimates, but relies on national estimates, so this data is likely to be similarly plagued by issues of comparability

Figure 1 – Spending on STEs in 5 countries according to two different OECD sources (% of GDP)



Reading: Spending on social tax expenditure in five different countries, in % of GDP. Different years are represented in OECD 2010, depending on the country: data for Germany, the Netherlands, Spain and the UK is from 2006, data for the US is from 2008. Data from Adema et al. (2011) in the graph is for 2007 for all countries. For each country, the left hand bar corresponds to the total cost of the STE programs recorded in Adema et al. (2011); the right hand bar corresponds to the subpart of the total amount of tax expenditures, that correspond to STEs (and not to economic incentives or other types of TEs, in OECD (2010).

Among both sources, the Net Social Expenditures dataset is the most useful for welfare scholars. It allows substantiating the claim that STEs are a substantial phenomenon in Europe. It also allows identifying some of the main policy domains in which STEs are prevalent, across countries. Yet, caution should apply when it comes to using this data for descriptive or comparative purposes, as there is a good chance that it captures only a truncated picture of the phenomenon under study.

First, the division of the dataset in three parts (part A is concerned with the direct taxation of social benefits, part B documents the indirect taxation of consumption out of benefit income, and part C is made of estimations of Tax Breaks for Social Purposes) leads to an underestimation of the data on TBSPs, since some STEs such as reduced tax rate on pensions or unemployment benefits, or reduced VAT for drugs, might be recorded in part A and B, and excluded from part C. For our purpose of estimating the sums spent on various STEs, this information is thus lost, because part A and B record itemized tax rates, and do not provide estimates of revenue foregone.

In the same manner, some STEs might be already recorded in the OECD social expenditures database (Socx), and thus be excluded from part C of the net social expenditure database: this is the case, for some countries (like the United Kingdom), of the part of tax credits that is paid out to beneficiaries, and not offset against tax liabilities (which, in many case, represents the lion’s share of tax credits). In this way, a significant part of STEs is likely to be left out of the picture.

In part C itself, 27 % of the data is missing; it is not clear whether these missing data points correspond to non-answers from national governments, or simply to the absence of any estimation at the national level.

Data on pensions are systematically reported separately, as “memorandum items”, because of comparability concerns (since different calculation rules are used in different countries).

Second, some specific STEs are also missing, which could potentially be included, such as tax breaks for firms, intended as incentives for job creation, mortgage-friendly policies, or some STEs subsidizing optional occupational welfare schemes. This is due both to the restricted definition of TBSPs adopted by the OECD[11], and to arbitrary decisions on reporting at the national level. Indeed, the questionnaire sent to governments contains very little guidance, and ultimately leaves to national administrations the decision of what to include in the report. There is no harmonization *a posteriori* either. The result of this is an important variation in the data reported, both between countries, and between years for a given country.

Thus, beyond systematically underestimating the size of the phenomenon, this data is likely to lead to flawed cross-country comparisons, and to bias longitudinal analyses: indeed, apparent changes in the data might reflect arbitrary modifications of the perimeter, changes in estimation techniques, or improvement of tracking systems at the national level, rather than an actual increase in spending.

Overall, while this dataset is useful to get a preliminary picture of the phenomenon, we argue that it should not be used for comparative purposes. The likely underestimation inherent in the data should also be kept in mind when using it for descriptive purposes.

The following graph (figure 2) represents STEs as a percentage of total public social spending in 15 OECD countries, highlighting the two policy sectors concentrating most spending on STEs in each country. We include it mainly to illustrate the starting point of this paper, i.e. that STEs are used, for a variety of welfare policy purposes, across European countries; all the limitations highlighted above apply to the data presented in this graph.

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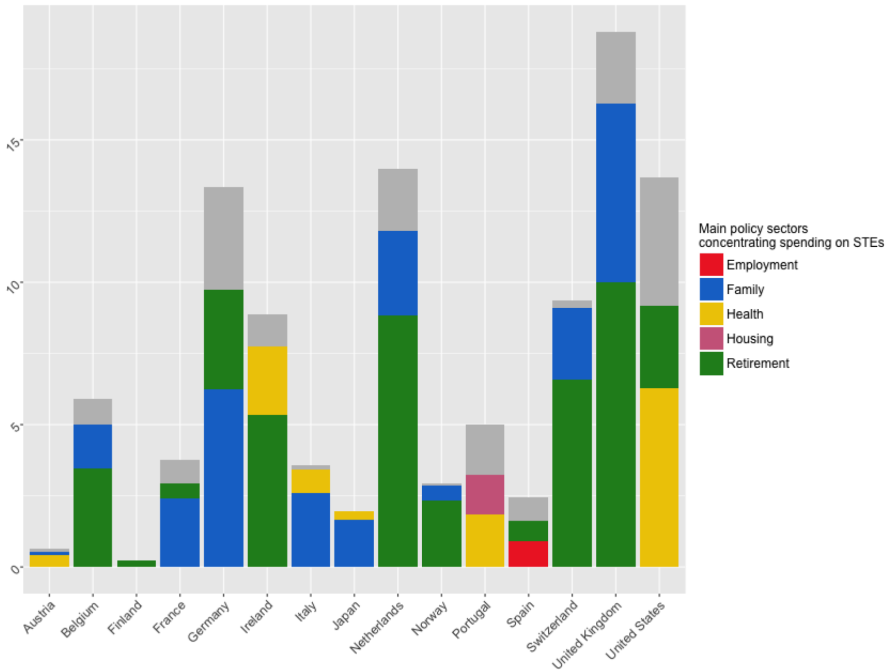
[11] To be considered a TBSP, schemes have to "be intended to address one or more social purposes", and to involve either inter-personal redistribution or compulsion (Adema et al, 2011:90). Following this definition, some STEs incentivizing voluntary occupational schemes are likely to be left out.

Figure 2 – Spending on STEs in OECD countries in 2011 (in % of total public social spending)



Source: own calculations based on data from Adema et al. (2014) and OECD Socx (accessed in January 2016). Data on pensions is included, since we are not using this graph for cross-country comparisons - considering that pensions seem to represent a very large part of spending on STEs in certain countries, it seemed more misleading to exclude them than to include them.

There are two reasons why the existing data on STEs gathered so far is still plagued by the limitations highlighted above, beyond the sheer lack of attention from researchers and governments alike, until relatively recent times. First, the cost of STEs cannot be measured: it has to be estimated. Producing accurate estimations of the budgetary costs incurred by states has proven a difficult enterprise (Altshuler and Dietz, 2011, Kleinbard 2008). Three main methods are used to estimate the cost of

TEs in the literature (Swift, 2006), each with its own challenges and limitations: the *revenue gain method* estimates the expected gain for public finances if a particular TE was to be abolished; hard-to-estimate behavioural changes and interaction effects need to be factored in. The *outlay equivalence method* estimates the net cost of the direct expenditure which would be necessary to achieve the same post-tax distribution, if replacing the TE in question; it is a more distant estimation of costs really incurred. The *revenue foregone* method measures the government's lost revenue as the difference between the respective tax liabilities of a taxpayer getting the TEs, and a similar taxpayer not affected; but this method (recommended by the OECD) does not take into account chain reactions in the tax and benefit system, or behavioural change. This could lead to either over or under[12] estimations.

The complexity of these estimation techniques, coupled with a relative lack of attention until fairly recent times, means that national administrative data on the subject is still largely incomplete. Some cases of "departure from the fiscal norm" are not recorded as tax expenditures and their cost is not regularly estimated (this is typically the case for social security contribution exemptions). More generally, the quality of estimations (both *ex ante* and *ex post*) is uneven. In France, in 2009, more than half of the tax expenditures were not evaluated. In 2010, only "estimates" were available for a large number of them (Pollard, 2011). Estimations are often exactly the same from year to year (with no account taken of the effect of either economic activity or inflation). In the UK, Sinfield (2016) has shown that while the Office for Tax Simplification has identified 1140 forms of tax relief, Her Majesty's Revenue and Customs (HMRC) acknowledges 400 tax reliefs, only 200 of which are costed.

[12] Actual costs could be magnified through behavioural reactions, for instance if the TE is used for tax optimization purposes, or through interactions with the rest of the tax and benefit system, if the TE pushes some people in lower tax brackets (Burman et al 2008)

The second difficulty is linked to the production of cross-country data in particular. Namely, the task of defining a consensual common “normal tax benchmark”, against which to define what an STE is, is deemed near impossible. Reliably comparable data is extremely difficult to produce because, beyond the complexity inherent in finding a “norm” to multiple idiosyncratic tax systems, doing so would also necessarily involve a degree of arbitrariness, which sits uneasily with the desired neutrality of the researcher.

Taking into account both the limitations of existing data and the difficulties in generating better data, we argue that future research should focus on producing two types of data: country-specific data, and comparative data at the policy level. Focusing on the first type would allow guaranteeing better internal consistency over time, and getting a clearer picture of fiscal welfare in specific national contexts. Such data is already emerging in some countries (see e.g. Houssoy and Zemmour, 2016, for France), and should be pursued further. For comparative purposes, focusing on producing reliably comparable data of similar policies would allow bypassing many of the issues linked to the absence of a common benchmark, and limiting the degree of arbitrariness involved.

In this endeavour, micro-simulation models are likely to be particularly useful. In particular, the EU-wide model EUROMOD, which simulates the effects of national tax and benefits systems for the 28 EU member states using household income survey (Sutherland and Figari 2013), is particularly adapted to generating data on European fiscal welfare. EUROMOD automatically includes certain type of STEs (such as in-work tax credit, and family tax credit), and can also be used to simulate data for some STEs conditional on private expenditures (such as, e.g. STEs incentivizing the purchase of private pension plans) provided complementary data on consumption of these services is available. But some forms of STEs, that are not linked to income tax or personal social security contributions, but to other forms of taxes (such as, e.g., corporate tax, or employer’s social security contributions) cannot be simulated using EUROMOD.

Thus, although the model has already been used to include specific STEs in distributive analysis on the welfare state (e.g. Avram et al. 2014), EUROMOD only allows drawing an incomplete picture of the distributive effect of fiscal welfare as whole. Yet, an important reason why producing more reliable data is needed, beyond obtaining a complete and more fine-grained description of the welfare state, is linked to the distributive effect of fiscal welfare. As explained above, available data is likely to be skewed (with some forms of tax expenditures, e.g. in-work tax benefits more visible and well-monitored than others in administrative data); thus even the few existing evaluations of the distributive impact of STEs draw an incomplete picture. In order to better assess the distributive profile of different welfare states, better and more comprehensive data on fiscal welfare needs to be included.

IV. The uses and potential effects of STEs in European welfare states

Having dealt with the conceptualization of fiscal welfare, and having drawn a road map for its better quantification, a third important question needs to be addressed, namely why governments use STEs (as opposed to benefit in cash or in kind), and how this use transforms national welfare arrangements. This question has already received significant attention in the US context; yet the emerging literature on European fiscal welfare tends to demonstrates that different trends are also at play there, that are specific to European contexts.

1. Insights from the US-based literature

The question of why and how STEs are used has been the subject of extensive studies in the American context, this literature highlighting some of the specificities of STEs, and pointing to some of the reasons why STEs can be attractive instruments in the social policy field.

Tax instruments are described as discreet and less traceable than traditional social welfare instruments. Democratic and popular scrutiny might be lighter (Hacker, 2002:44). Legislative and bureaucratic processes of the "hidden welfare state" are also described as less constraining than those characterizing direct social expenditures (Howard, 1997:30). Fewer veto points characterize the policy process in the US context when using "hidden welfare" instruments.

Political processes also appear to be different: the ambiguity that is described as inherent to fiscal welfare instruments (Howard, 1997:141), means that they can be embraced on multiple grounds. In that sense, they are an ideal policy tool to cut deals and reach compromises, because they can be framed in many different ways that can suit broader coalitions than traditional "visible" spending.

STEs would be an ideal tool for Conservative governments to mobilize in a "layering technique" in order to transform well-entrenched policies: private programmes, publicly subsidised through tax expenditures, can be discretely added on top of direct spending programmes, in order to attract beneficiaries to the new layers and away from the former ones. Conservatives thus manage to "curb the demand" for traditional direct spending programs. According to Howard, this has been "the general pattern" of social policy making in the US in the twentieth century (Howard, 2007:90). STEs can also be mobilized in "starve the beast" (Bartlett 2007) strategies, in order to limit the future growth of direct spending programs, through reducing available public revenues (Howard, 1997:4).

STEs would be used to foster privatization and the development of occupational forms of welfare, "*altering the balance between public and private power in society*" (Faricy, 2011:74). Thus, Hacker shows how third-party providers might be empowered through tax expenditures, and subsequently able to mobilize very large resources to maintain these policies (Hacker, 2002:56).

Beyond privatization, tax expenditures are associated with a free-market logic, concepts like individual choice or self-reliance (Howard, 1997:11). Working through individual incentives rather than top-down regulations of social entitlements, they would be a better fit with the self-image of the middle class than direct spending (Gilbert and Gilbert, 1989). They are described as a "*less intrusive, less bureaucratic alternative to government regulations or direct expenditures*" (Howard, 1997:8).

Finally, due to their specific distributive propensities, STEs would be used to appeal to higher and middle-class voters. Indeed, progressivity means that upper-income taxpayers generally benefit more from tax expenditures (Howard, 1997:31). STEs also reward behaviours that "*less affluent taxpayers cannot afford to engage in (e.g. owning a home)*" (Howard, 1997:31). Occupational tax benefits are also more likely to concern workers in large companies, with secured employment and above-the-median wages. At the same time, some tax expenditures are also explicitly targeted at low-income people: the implementation and development of the Earned Income Tax Credit (EITC) are described as the result of party competition for the vote of the working poor (Howard, 1997:188).

2. Descriptive trends emerging from the still patchy literature on the uses of STEs in European welfare states

Both the descriptive and analytical contents of this literature can feed into analyses of the European case in a relevant manner. Yet there are many reasons to think that the political economy of STEs in Europe might be different, not least due to the fact that European welfare states are larger, more mature and legitimate institutions. Political processes are also very different, with generally fewer veto points and less formal opposition to social spending. The ideological direction of reforms in the US and Europe cannot be simply assimilated either; thus the use of similar instruments cannot be assumed to mean that similar aims are pursued and similar reform logics followed.

Thus, we need more empirical insights into the particular uses of social tax expenditures in European welfare states, and possibly new theories to account for and understand the effects of the development of STEs in the European context. Although it is still in its early development, a literature on fiscal welfare in Europe is emerging, with particularly informative national case studies, partially filling in the data gap highlighted above[13]. Surveying this literature allows identifying common trends in the uses of fiscal welfare in European contexts, which enables us to put forward a number of hypotheses on the uses and effects of STEs in a European context. More precisely, we identify four trends which would warrant further analysis.

a. STEs as a social policy instrument adapted to times of fiscal austerity

First, several accounts tend to show that STEs would be particularly well adapted to social policymaking in contexts of austerity. This assertion is linked to two different types of uses of STEs of which we find several examples in the literature; namely, in fiscally constrained contexts, STEs could allow bypassing accountability rules, and could represent means of affordable credit claiming.

In institutional contexts characterized by the implementation of legally binding expenditure ceilings, STEs seem to be a way to maintain spending on social policy. Indeed, although in theory, a deficit-adverse government should avoid both direct and indirect forms of spending[14], in practice, STEs often constitute loopholes in government's hand-tying devices. This is due to the fact that budgetary control instruments almost always consist of a formal control of public expenditures, rather

[13] In an attempt to foster research on this understudied area, we have organised a workshop in Paris in May 2016 and set up a website for collaborative and dissemination purposes: www.fiscalwelfare.eu

[14] Additionally, European treaties (Maastricht Treaty, TSCG) are concerned with overall levels of fiscal (im-)balance, not by absolute levels of expenditure and/or revenue.

than a control of the overall balance[15]. For instance, France has a binding ceiling of public expenditures, voted each year, which cannot be breached unless a specific corrective bill is passed. In contrast, the level of tax revenue considered in the budgetary bill has the legal status of a mere prevision. Consequently, if an STE happens to be much costlier than expected, the unforeseen cost will not entail any automatic reaction and the STE will benefit every eligible taxpayer. Moreover, an increase in spending in the form of STEs is likely to simply go unnoticed, because the monitoring of tax expenditures is often incomplete, as explained above (see part II).

Consequently, the skyrocketing cost of a tax expenditure may well remain unnoticed for several years; the revenue loss will simply be considered lost in the gap between tax prevision and tax collection. In contrast, the traceability of public expenditures is excellent: the unforeseen drift of a social benefit cannot remain unaddressed for more than a few months. This lack of cost estimation means that STEs might also be easier to introduce. An example of this is the 2003 pension reform in France in 2003, which main purpose was to balance the pension system in the long term. All measures included had to be examined ex-ante and their budgetary impact estimated. However, one scheme had no estimated cost attached: a social security contribution exemption for employers subscribing to certain types of occupational pensions. Yet, this cost was far from negligible: ten years later, it was estimated to be worth at least 1.3 billion euros (Houssoy and Zemmour 2016). Consistently with the argument brought up in the American literature, according to which STEs do not mobilize the same public attention as direct social expenditures, the introduction of this measure was barely noticed by commentators and did not trigger debate or opposition, while the overall reform was generating public outrage.

[15] In the same way, the European Commission, which theoretically only looks at the deficit size, pays in practice a particular attention to the total amount of public expenditures (notably through the European Semester budgetary review procedure).

STEs can also been used as a means of “affordable credit claiming”; they are at first sight cheaper to implement as they do not necessitate the setting up of a specific bureaucracy to examine claimants’ applications and to manage the payments. Beneficiaries simply indicate in their tax file the deductions or reductions they are entitled to (for instance for the purchase of childcare or household services). Likewise, income support for low-wage earners is handled by the tax authorities rather than a social service. Because no additional layer of administration is necessary, the use of STEs can be portrayed as part of a larger effort to make the welfare bureaucracy leaner and more efficient. Additionally, STEs help governments to appear as more responsible since they can be portrayed as tax cuts rather than increased spending. Thus, using STEs “allowed New Labour to be modestly expansionary while still respecting (…) their 1997 election pledge (…) to remain within the very tight spending plans of their Conservative predecessors” (Clegg, 2015:9). In other words, it allowed New Labour to appear “responsible”, even according to Conservative standards.

b. STEs as “modernized” social policy: new risks, new actors, shorter processes

Second, existing empirical descriptions of fiscal welfare in European countries tend to show that the use of STEs would be part of a phenomenon of "modernization” of the welfare state. They are used to answer new types of social risks, and they tend to be implemented by actors and through processes that are different to those traditionally characterizing social policymaking.

A survey of the welfare state reform literature[16] indicates that STEs have been used across Europe in the fields of active labour market policy, as well as in family and childcare policy, that is to say in relation to what has been termed ‘new social risks’ (Bonoli, 2005). In the field of family policy and childcare, tax allowances or tax credits for families have emerged in a number of countries, especially since the 1990s (cf.

[16] Available in the Working paper version of this article (Morel et al. 2016b)

Ferrarini, Nelson, Höög, 2012). STEs are also present in reforms favouring the development of private providers of childcare services, through tax deductions for formal care expenditures. In the field of active labour market policies, STEs are used in reforms that seek to 'make work pay' by providing wage subsidies to low-income earners through income tax credits. The *Working Families Tax Credit* introduced in the UK in 1997, the *Prime Pour l'Emploi* in France in 2001, or the *Jobbskatteavdrag* in Sweden in 2010 are examples of such instruments. STEs are also used as incentives designed to encourage job-creation, for instance, in the form of exemptions of employers' social security contributions on specific jobs (low-wage jobs, jobs in particular sectors) or specific categories of individuals (for instance young or senior jobseekers).

In accordance with the point made above, the use of tax expenditures in these areas can be understood as offering room for manoeuvre for governments to respond to these new needs in a context of budgetary austerity. Beyond, they also seem to fit in well with the political agenda of activating people rather than keeping them "dependent" on social transfers. They are also aligned with the dominant contemporary drive towards "individualisation" and "free choice" (Ervik, 2000:245), which seem to constitute the new horizons of social policy. With respect to childcare for example, tax expenditures enable parents to purchase the types of services they wish between competing providers, rather than imposing a 'one-size fits all' public childcare service for instance. This does not mean that STEs are more technically prone to enhance free choice: "cash-for-care" schemes in the form of a benefit (i.e. a direct expenditure) in effect allow beneficiaries to exercise free choice when purchasing care services. Still, STEs seem to be more strongly associated with this new social policy repertoire. They can be used to foster the development of a variety of non-state service providers which development is associated with the drive towards free choice (see below).

Since they aim not at decommodifying labour but rather at enabling more people to participate in the labour market, STEs are more likely to benefit from the support of non-traditional welfare constituencies, such as employers and Right-wing parties. Non-traditional actors are also involved because STEs are discussed in specific institutional arenas (the ones traditionally used for tax policy discussions), different from the traditional social policy arenas. Traditional social policy elites (like trade unions representatives, officials from social security institutions, etc.), usually associated to formal processes of social policy negotiations in many countries[17], are likely to be side-lined when STEs are used. Instead, relatively new actors like finance ministries administration are often involved in the design and management of STEs (see e.g. Clegg, 2015).

This is likely to bear consequences, as finance ministry officials are often primarily sensitized to the issue of budget balancing, while social policy objectives come into consideration only as secondary and even contradictory aims. Thus, in Poland, a tax expenditure for families was introduced in 2006, and proved to benefit mostly higher income families. In 2007, discussions to include a negative income tax mechanism to remedy that problem were cut short, partly because Ministry of Finance officials objected that the amount of foregone revenue would be too high, especially as the country was entering the Eurozone's Excessive Deficit Procedure (Polakowski and Szelewa, 2016).

Using STEs also potentially simplifies the legislative process, as implementing STEs do not require voting a dedicated text: they can be implemented in any budget bill. This means that the window of opportunity to create, modify or suppress STEs opens at least once a year. Using STEs is thus a way to intervene quickly on social issues. For instance, in France, two schemes are designed to support the cost of elderly care, a means-tested in-kind benefit ("allocation personnalisée d'autonomie") and a targeted tax reduction (mostly used by the wealthiest, Carbonnier, 2015). Between 1991 and 2014, there were three legal changes to the in-kind benefit (concerning its scope, eligibility, etc.) in 1997,

[17] For instance, in France social partners control the use of public subsidies to collective childcare structures, since they are in charge of administering the social security fund dedicated to family policy (CNAF). On the other hand, they have no direct control on the variation of childcare tax credits (they can at best express an opinion through the Haut Conseil à la Famille, a broad consultative body).

2001 and 2003; these three reforms were each included in a dedicated bill and voted in Parliament during a process that lasted at least three months. During the same period, there were eight comparable changes to the targeted tax reduction (ceiling, eligibility), mostly through simple articles in the budget bill (1992, 1995, 1997, 2002, 2003, 2005 and 2011) (Carbonnier, 2015).

c. STEs as a tool to foster the partial privatization of welfare

A third trend identified in the literature on European cases is the association of fiscal welfare with a “privatization logic” (Sinfield 2012). OECD data shows that pensions stand for a large share of STEs in many countries; other sources also underline the importance of healthcare. These policy sectors also represents very large shares of total public social expenditure, making them the focus of governments’ efforts to curb spending.

In this context, it seems that STEs are sometimes used to encourage the development of private (pension and healthcare) insurances and to reduce the reliance on public insurance programs, through stimulating either the supply or demand of private welfare services. In particular, in countries where the demand for private insurances is crowded out by generous mandatory public insurances, STEs are a way to encourage employers to supply occupational welfare schemes, thus shaping previously inexistent private markets. Another example, on the demand side, is the introduction of tax credit schemes in a number of Continental and Nordic countries, with the explicit aim of fostering the development of a personal household services sector for both care and non-care needs (Morel, 2015; Carbonnier and Morel, 2015).

STEs are also used to organize newly created markets. Governments have an opportunity to shape the services produced by the market, through STEs conditional on private consumption, which are associated to a legally defined service. STEs can be restricted either to approved providers or to services fulfilling certain criteria. Thus, other services, in a business close to but excluded from the target of the tax breaks, are disadvantaged. The market for private health insurance in France provides a good example (e.g. Kerleau 2009). The introduction of a payroll tax exemption, restricted to i) compulsory occupational schemes, regulated by a collective agreement, ii) offering a minimal "care basket" and excluding certain forms of risk selection, has strongly disadvantaged other forms of health insurances (such as individual and voluntary contracts), which used to dominate the field. It also created a strong incentive for providers to redefine their offer accordingly. This is significant in explaining the ongoing reorganisation of this sector (e.g. Batifoulier, Domin and Gadreau, 2008; Dormont, Geoffard and Tirole, 2014). Far from signalling a rollback of public intervention in favour of a "free" market, the use of STEs in this case appears to be a (costly) means of publicly subsidizing and organizing a private market.

Beyond creating and steering markets, the use of STEs also results in the diverting of earmarked public resources towards private schemes. In France, employers' participation to collective private social insurance (health and/or pensions funds) can be partly exempted from contributions to mandatory social insurances. This allows a partial transfer of public resources to private schemes: a share of labour cost, which should accrue to public social security funds through social contributions, is diverted to a private insurance. In 2011, the resources diverted from social security to private insurances amounted to at least 4.5 billion euros for health insurance and 2.5 billion euros for pensions (while the market for private insurance amounted to 30 and 10 billion euros respectively) (Zemmour 2013).

d. Beyond social policy: governing through incentives, defining norms of deservingness

Fourth, and finally, a survey of the emerging European literature reveals that STEs might be used, beyond their social policy function, as a specific governance tools designed to alter economic and behavioural incentives, and thus defining and concretely embodying social norms of deservingness.

STEs are a means of governing through incentives. An important way in which they differ from direct social expenditures is that they do not necessarily primarily aim to redistribute, but rather to alter incentives. This can relate to economic incentives (encouraging individuals to purchase private goods or services – a home; private insurance plans; household services; or encouraging employers to finance private insurance schemes for their employees). But incentives can also be directed towards fostering a desired behaviour with respect to labour market participation or to marriage and fertility (e.g. tax advantages for married couples; tax benefits linked to the number of children).

This mode of governance through incentives is likely to entail a greater degree of targeting, and could be used to more discreetly target specific demographics or electoral constituencies. Branco & Costa (2016) for instance suggest that the development of STEs in Portugal can be understood in light of the transition to democracy in a context where electoral volatility has led political parties to target specific segments of the population amongst the middle class and the elite as a way to mobilize these constituencies.

As incentives, STEs can also be used as a means to (re)define norms of deservingness. For instance, an interesting development is the way in which family benefits have become increasingly tied to labour market incentives in a number of countries. This has typically been the case in the UK for the Working Families Tax Credit, and has become the norm in some countries of Central Eastern Europe also, where family benefits in the form of direct transfers have been replaced by tax benefits conditional on employment. This is the case notably in Poland, the Czech Republic and Hungary (cf. Polakowski & Szelewa, 2016 ; Jahoda & Godarová, 2016 ; Szrika, 2016). The aim there was notably to reinforce the distinction between the deserving and non-deserving citizens. This idea was made explicit by the Ministry of Labour and Social Affairs in the Czech Republic, who stated: "By taking this step, the state wants to strengthen incentives to encourage employment and thus reduce the number of people dependent on social benefits" (quoted in Jahoda & Godarovà, 2016 :6). Likewise, Szrika notes how in the case of Hungary, "the more generous, post-1990 social policy efforts that aimed at the creation of a welfare state […] and promoted the development of certain social transfers as universally available to all citizens who need them, has been fading away. In the understanding of the Orbán-government social rights are not any more based on ??Szrika, 2106:21).

The same holds true for STEs mobilized for the purpose of 'activation' and of 'making work pay'. According to Clegg tax expenditures introduced under New Labour precisely aimed at signalling that "recipients of in-work support had a different, and superior standing to recipients of 'welfare'" (Clegg, 2015:10). This particular use of STEs would thus amount to a means of (re)drawing of the boundaries of welfare and social citizenship, with possibly important distributive consequences.

Conclusion

Based on the above discussion, it is safe to conclude that the issue of STEs in European welfare states is a subject that needs to be more thoroughly researched. STEs are present in Europe, and represent substantial amounts of public monies. They seem to be used for a variety of reasons, from social policymaking under austerity, the modernization of welfare and its partial privatization, to economic and political objectives, beyond social policy. They appear to be mobilized because of some distinctive intrinsic features, which make them *technically* attractive in the face of certain institutional or regulatory constraints, as well as because of their association with certain policy trends and discourses, which make them *politically* attractive.

Yet this paper also leads to the conclusion that the literature as it stands still lacks accounts of both the ways in which STEs are mobilized and the rationales behind their uses in specific national contexts, as well as their longer term effects on national welfare states. This article allows acknowledging that much, and constructing a basis on which to build future research. We mapped out the existing conceptual discussion, and concluded that the concept of Social Tax Expenditures was the best adapted to research on the political economy of welfare; we identified empirical gaps in the available data, and exposed the challenges involved in generating better data; this led us to argue in favour of the development of cross-country comparisons at the policy level, as well as the development of country-specific analyses. Finally, we identified empirical trends emerging from the patchy European literature on fiscal welfare, which can be used as cues in building a theory of fiscal welfare in European countries; doing so, we also revealed remaining theoretical gaps, in particular when it comes to the effects of STEs. In that sense, the present article is only the first building block of a larger endeavour.

It remains to be added that the emerging trends identified in the second part of this article might very well be particular to a specific context and time on which the existing literature is concentrating, namely the 1990s and early 2000s. Yet this context is changing. Thus, the renewed fiscal surveillance applied in the EU (and especially in EMU countries) since the 2012 crisis means that tax expenditures are increasingly taken into account in budgetary processes as well: the new European System of Account issued in 2010 prescribes that the refundable part of tax credits be reported as public expenditures. A European Regulation adopted in 2011 prescribes yearly detailed reporting of tax expenditures and their impact on state revenues in Member-States. This renewed attention to tax expenditures in accounting systems could explain the multiple instances, since 2010, of suppression of tax expenditures in order to broaden the tax base (examples are the United Kingdom 2010, Greece 2010, Portugal 2010, Ireland 2010, and France 2010[18]). Future research should take this changing context into account, and look in particular at the issue of whether some types of STEs are more likely to be cut than others.

[18] In France since 2010, we witnessed a general policy of reducing the generosity of certain tax benefits (reduction of ceiling on *Quotient Familial*, freeze of the *Prime Pour l'Emploi*…)

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