Preventing in-work poverty, promoting low-wage employment or both? Effects of in-work benefits in international perspective.

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Jan Brülle, Goethe-University Frankfurt

In the light of structural changes in labour markets, public benefits to employed households are an important aspect of modern welfare state (Kenworthy 2019). At the same time, in contrast to benefits to the out-of-work population, they are rarely analysed in comparative perspective. Available evidence usually focuses on specific examples of these benefit systems, including systems of tax credits in anglo-saxon countries in particular. This misses the fact that welfare states often support employed households in the guise of social assistance or family benefits (Clasen 2020). Even if 'hidden' in other benefit systems, benefits paid to employed households matter for the structure of labour markets and overall inequality, because they potentially promote low-wage work, while also bolstering incomes among low earners.

Challenges to welfare provision in post-industrial societies suggest an important role for in-work benefits to address the needs of those with low-earnings. Simulation studies show that the introduction of in-work benefit programmes can more efficiently reduce inequality than expanding existing welfare systems (Immervoll u. a. 2007), because they can alleviate the negative implications for work incentives by lowering marginal tax rates for individuals entering the labour market. Indeed, tax credit programmes in the US and the UK have been shown to reduce poverty risks and increase employment at least among selected groups (Brewer und Hoynes 2019).

While in-work benefits can boost employment, these benefits also have unintended consequences: because benefits are withdrawn at higher earnings, they can lower incentives for households to increase their labour supply beyond a certain level – i.e. with respect to the intensive margins of labour supply (Brewer und Hoynes 2019). Furthermore, the positive effect on labour supply might come at the cost of decreased job quality: if the unemployed are willing to accept lower wages, because they are topped up by public transfers, this will increase the incidence of low-paid employment. Employers could also react strategically to the introduction of in-work benefits by lowering wages. Indeed previous studies show that tax credit programs in the US and the UK slightly decreased wages (Leigh 2010; Rothstein 2010; Azmat 2019).

Considerable gaps in the literature remain: whereas studies consistently show positive effects on employment participation and poverty relief of the introduction of in-work benefits in the US and the UK, little is known for countries that do not belong to the family of liberal welfare states. Furthermore, evidence on potential unintended consequences of benefits – a decrease of work incentives for secondary earners and an increase in low-wage employment – is sparse, even in the case of tax credits. In my presentation, I will present new evidence on these issues, by leveraging international variance in the provision of in-work benefits to estimate effects on earnings and household incomes.

The analyses use novel indicators on the generosity of benefits to low-earning households, including dedicated in-work benefits as well as social assistance benefits. These indicators are calculated based on OECD tax-benefit models and merged to multi-level data from the EU-SILC. The analyses is based on 31 countries between 2003 and 2020 and I estimate multi-level linear probability models that control for stable differences between countries using fixed effects.

The results show that benefits to low-earning households can contribute to lower poverty among employed households. In contrast, there is no robust evidence on higher risks of low-wage employment in contexts with higher benefits to low earners. Also, the effectiveness of benefits to low earners in combating poverty depends on the institutional and structural context: in particular, generous benefits more effectively reduce in-work poverty in contexts where a relatively generous minimum wage is in place.

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