Comparing Tax Routes to Welfare in Denmark and the United Kingdom

Jon Kvist & Adrian Sinfield

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ABSTRACT

The use of the tax system to meet particular needs and to encourage specific activities or behaviour in relation to welfare has not received as much attention as its role in financing direct public spending or encouraging other economic objectives. The cost, distribution and general impact of tax benefits have been overlooked while spending on the public welfare state has come in for ever increasing attention. This study seeks to compare the routes to tax welfare in two countries, Denmark and the United Kingdom, as a contribution to developing a better understanding of the different routes and their implications for both individual and broader welfare.

Growing awareness of the costs of some tax expenditures has led to some specific changes in the United Kingdom while two major tax reforms in Denmark have led to a more systematic removal of tax expenditures, especially those deriving from tax free public benefits. In both countries the greatest reductions to tax expenditures on welfare have been through the lowering of tax rates which has also reduced the value of tax benefits. The exact extent of the decrease, however, is concealed by the lack of detailed statistics monitoring changes over time.

In both countries the tax route to welfare still confers considerable benefits. In the United Kingdom these are predominantly 'up-side down' benefits which are of greater value to those with higher incomes. In Denmark the tax benefits are now generally more evenly distributed, but both countries still promote some provision (for example, occupational and individual pensions) through generous tax reliefs.

The operation of tax routes raises many issues of equity and privilege, of cost and value for money which have been neglected in comparison to the scrutiny of public spending. They deserve much closer attention both in research and in wider public debate.

COMPARING TAX ROUTES TO TO WELFARE

Introduction

In 1984 a report from the Organisation for Economic Co-operation and Development began: 'It has been recognised for some time that tax reliefs can be used to implement government policies and may often be substitutes for direct expenditures' (OECD, 1984, p.7). Such a matter-of-fact opening suggests that the observation is both widely known and totally non-controversial. Over a decade later one might perhaps have expected that it would have become common knowledge and a well-established part of policy-making. In fact, over a period when there has been increasing discussion and concern in most countries about the scarcity of resources to fund growing budgets for public expenditure, the report has received far less attention than might have been expected.

By contrast the question 'Can we afford the welfare state?' is a constant theme for debate which

(Photo: Julie Rønnow)

takes place without any recognition of the role played by the tax system in government strategies. In many countries the cost of the welfare state has become one of the central issues for political debate, perhaps the central issue in others, and particularly in regard to pensions. 'A demographic timebomb is ticking away in all EU countries' was the way in which the Federal Trust's report, *The Pensions Time Bomb in Europe*, was introduced on Danish radio in January 1995, and the same line was taken up in the United Kingdom and other countries. 'Grey timebomb at the heart of the Western welfare state' proclaimed the headline in the *Guardian* (27 January 1996) over an analysis of many countries which was clearly influenced by the concerns of some ministers of finance and international economic agencies (e.g., World Bank, 1994). The general theme of these and similar reports is that the state and the hardworking tax payer cannot be expected to carry on providing generous public benefits and that the individual must be expected to take more responsibility, to take an 'active line', in meeting his or her needs by investing in private arrangements before the state collapses under the strain.

In this report we give particular attention to the ways in which the tax system can and does affect the provision of welfare in two countries. The first part provides a theoretical and methodological framework for analysing tax routes to welfare. Traditionally only one of the two roles of tax systems, raising revenue for public spending, has been the subject of systematic analysis and the other role, running separate spending programmes, has been neglected. We focus on the ways on which the tax system can meet needs and encourage activities through the provision of allowances and reliefs and discuss how tax expenditures and tax benefits can be measured. The growing recognition of tax expenditures in academic analysis and public policy-making in Denmark and the United Kingdom is then outlined. The limited evidence available for broader crossnational comparisons of the extent of tax expenditures is considered before we move to a more detailed examination of experience in the two countries. We discuss recent developments in policy and practice relating to tax expenditures and tax benefits in Denmark and the United Kingdom and attempt to give an indication of present tax routes to welfare and their costs. Who benefits from tax benefits deserves as much consideration as their overall cost. The last part of the analysis is devoted to the subject of retirement provision, probably the most significant area of both conventional social policy and tax welfare. This provides a case-study for discussing and evaluating the various aspects of tax welfare. Incorporating the impact of policies carried out through tax reliefs raises important questions about who benefits and who pays, and about the openness and accountability of this area of government which has been called 'the hidden welfare state' (NCW, 1976; 1979; Greve, 1994; Howards, 1993).

In the report, however, we are very conscious that we have only begun to raise some issues and have not been able to explore many of them fully. We have only considered the benefits from income tax expenditures and not from any other form of taxes. We have not taken account of the implications for taxation and the distribution of welfare of fringe benefits and the whole range of public services. We have concentrated on the social policy issues and have not paid as much attention to other objectives of the individual policies. For example, tax reliefs for pensions may serve to stimulate individual savings, but we have been concerned to examine the broader social policy and welfare implications of this.

The welfare state in Denmark and the United Kingdom

The Danish and UK welfare states have been traditionally seen as based on the same basic principles in social security - universal coverage of the whole population with flat-rate benefits. These principles were formulated by Beveridge in 1942 and implemented in the United Kingdom after the war. Denmark had already introduced these principles in social legislation, re-affirmed them in the 1933 codification of social security, and this has led some observers to note that the Danes have a pre-Beveridgean welfare state (e.g., Nørby Johansen, 1986). However, others have argued that it was not until the late 1950s that Denmark had a Beveridgean welfare state with the building up of a universal flat-rate pension independent of income (e.g., Petersen, 1995).

In the postwar years, and particularly more recently, it is much clearer that the two countries have not been following the same road to welfare. Social benefits in the United Kingdom are relatively smaller than the Danish, and means-tested benefits play a much larger role in the United Kingdom than in Denmark. This can be explained, partly by the importance given to collective agreement minimum wages in Denmark while there are none in the United Kingdom, and partly by the more generous level of cash benefits in Denmark. Thus it is not surprising that a recent study on cash benefits in Europe concluded that the Danish cash benefit system is distinctly different from the UK (Ploug & Kvist, 1996). The UK system tends to promote the values of the market and self-reliance through an extended use of means-tested benefits for groups with no or low income and by encouraging individual, private forms of social protection through financial incentives and low replacement ratios in the state-run insurance schemes. In Denmark, in contrast, benefits cover broader groups with non-means-tested benefits which are significantly higher than the UK equivalents, especially for low or no income groups. For example, some two-thirds of people who are unemployed in the United Kingdom have to rely on social assistance (Income Support) compared to one-fifth in Denmark.

Finally, the UK welfare state relies more on insurance contributions than the mainly tax financed Danish welfare state; in 1993 National Insurance contributions amounted to 17% of public sector financing in the United Kingdom whereas social security contributions only amounted to 3% in Denmark (OECD, 1995). However, in neither of the countries do the majority of benefits depend on the size and number of contributions paid in an actuarial sense.

The comparisons of cash benefits and expenditures do not, however, take account of how the tax system works. With what limited evidence there is, we attempt to examine the differing extent, form and use of tax welfare in the two countries.

The dual role of tax systems

The traditional view of taxation has long been a one-sided one. 'Government derives receipts (in cluding taxes) to finance expenditures' (Musgrave & Musgrave, 1984, p. 219). The main priority for policy-makers from this perspective has been nicely caught by the great seventeenth century French statesman, Jean Baptiste Colbert, who was the Controller of Finances to Louis XIV, the 'Sun King': 'The art of taxation consists in so plucking the goose as to obtain the largest amount of feathers with the least amount of hissing' (quoted by Di Palma, 1977, p.10).

In this view tax reliefs and allowances are simply some of the means aimed at securing acceptance and legitimacy for taking resources away from people in order to raise the income the government needs to finance its programmes.

More recently it has come to be recognised that this view of the tax system is very limited. The system has - and in most countries has always had - another and quite significant role in the ways in which it treats certain activities or resources differently from others. In this way certain needs and objectives are acknowledged by the government with a special dispensation through the tax system. For example, taxpayers with dependent children may be considered not able to pay as much taxes as others on the same income but with no children to support and so a child tax allowance is established; or people are encouraged to buy their own homes or to provide for their retirement by varying forms of tax relief.

As a result of the reliefs provided, tax is foregone that would otherwise have been collected. And individuals benefit from these tax subsidies as they do from grants or services provided through the welfare state. Both these aspects have received little public attention in discussions of taxation although they are an integral part of discussions about welfare state spending. However, the loss of revenue to the government as the result of providing tax incentives or tax subsidies can have the same effect on balancing its budget as the payment of direct expenditures. Equally, the distributive effects of these tax benefits deserve as much consideration and scrutiny as do those of benefits which are part of public expenditure. The public programmes are constantly being examined to see if they are achieving the objectives for which they are intended and are meeting the needs of those in greatest need. In fact, in recent years there has been increasing concern, mainly but not only on the political right, that public benefits should be 'selective' and 'targeted' on those most in need, otherwise they are described as wasteful and inefficient both for the broader economy and the individual recipient.

The origin of the concept of tax welfare

This issue appears to have received its first systematic consideration some forty years ago in both countries. In the United Kingdom it was particularly examined by Richard Titmuss, the country's first Professor of Social Administration, in an essay on 'the social division of welfare' in 1955. In challenging the view of the welfare state as overgenerous in spoiling the poor at the expense of the rest of the society, he argued that there were other systems of redistribution in society which benefited those better-off at the expense of the remainder and were serving to reinforce the inequalities already existing in society. In addition to the visible system of 'public welfare', what today we would call the welfare state or state welfare, he drew attention to fiscal welfare and occupational welfare. He introduced the expression 'fiscal welfare' to refer to tax revenue lost in meeting needs or objectives similar to public welfare.

'Allowances and reliefs from income tax, though providing similar benefits and expressing a similar social purpose in the recognition of dependencies, are not, however, treated as social service expenditures. While one is "a cash transaction", the other is "an accounting convenience". Despite this difference in administrative method, the tax saving that accrues to the individual is, in effect, a transfer' (1955, published in 1958, pp. 44-5).

The third system, 'occupational welfare', refers

to the benefits a worker receives through employment, whether directly from the employer or through a trade union or professional association or work co-operative. In many countries the most widespread and valuable of these benefits is the occupational or company pension - and in most countries the building-up of this pension is both encouraged and assisted by especially generous tax reliefs. Government tax policy therefore is a major factor in promoting these pensions which supplement or complement state retirement provision. And more generally governments have been using reliefs through the tax system to reallocate resources among groups and services.

In Copenhagen in the same year, as Titmuss noted in his essay (p. 45, n. 1), a study was published on the *Co-ordination of Social Welfare Statistics in the Northern Countries* reporting the agreement of the five Northern Countries that 'tax deductions are quite analogous to ... allowances in cash' (NOSOSKO, 1955, p. 128). The study was the result of the Nordic Social Statistical Committee (NOSOSKO) set up in 1945 by the Nordic Council of Ministers with the purpose of gaining a better knowledge of welfare schemes and establishing a better basis for comparative statistics (NOSOSKO, 1951). And ever since then the reports of NOSOSKO have included tax benefits, although only for families.

In 1963, the second Danish professor of Social Policy, Jørgen S. Dich, broke with many conventions in his attempt to set up a general theory of social policy and partly incorporated some of Titmuss's ideas. The field of social policy could, according to Dich, be defined as 'all positive *public subsidies* to individuals in general or to certain groups confined by criteria such as illness, age, number of children, professional status (workers, farmers) etc. ... Subsidies may be substituted by fixing of maximum or minimum prices ... and by special tax allowances. Such concealed subsidies also fall within the sphere of social policy' (Dich, 1964, pp. 451-452).

In both countries these arguments received little general attention from policymakers and most public policy analysts. In the United Kingdom, although this issue remained very much of a minority interest even within the field of social policy and administration (Sinfield, 1978), it was brought into some policy debates in which academics were advising the Labour Party. In particular the 'rediscovery' of poverty in the early 1960s led to the setting-up of the Child Poverty Action Group in 1965 which campaigned for the improvement of universal family allowances at the expense of income tax allowances for child dependants.

The origin of the concept of tax expenditure

While the idea of fiscal or tax welfare was introduced in the 1950s, it did not become the subject of systematic analysis across the whole area of social policy in any country. However, the issue has been receiving increasing attention in many countries under another title. Over the last twenty years the term 'tax expenditure' has slowly come to be used to cover losses of revenue, whether concerned with welfare or any other objective. The introduction of the term constitutes recognition that, by granting reliefs and allowances, governments have for many years been 'intervening in the economic and social life of a country by running spending programs through the tax system'. (McDaniel & Surrey, 1985, p. 6).

The initiative for introducing the idea of tax ex-

penditure lies with Stanley Surrey, a lawyer from Harvard Law School, while he was U. S. Assistant Secretary for Tax Policy from 1961 to 1968. Some of Surrey's main achievements in tax expenditure were brought in after he left the Treasury. The tax expenditure list 'was an important document in the legacy which tax reformers, seemingly stifled under Johnson, left for the incoming Nixon administration' (King, 1984, pp.16-17). After a period of voluntary calculation by congressional revenue committees, a 1974 Act required that a list of tax expenditures be computed every year and published in the President's Budget and a report containing five-year projections of tax expenditure costs be released annually.

At the start of the 1970s only the United States and Germany used 'consolidated tax expenditure accounts'. By the time of the OECD review of tax expenditure practice published in 1984, Australia, Austria, Canada, France and Spain were also regularly publishing data and Ireland, Portugal and the United Kingdom published lists of all or the larger tax reliefs without distinguishing tax expenditures from the rest (OECD, 1984, p. 7). A decade later, in their most recent study, *Tax Expenditures: Recent Experiences*, data are included from 14 countries - Australia, Austria, Belgium, Canada, Finland, France, Germany, Ireland, Italy, Netherlands, Portugal, Spain, the United Kingdom and the United States (OECD, 1996, part 2).

The definition and measurement of tax expenditures and tax benefits

While the term 'tax expenditure' is now more commonly used and data are starting to appear in more and more countries, there continues to be debate over how tax expenditures are best defined and measured, and some still argue that the whole notion is flawed (for a trenchant critique of Surrey's work, see Wildavsky, 1985; and for a good discussion of the arguments for and against, see Bruce, (ed.) 1990).

'Tax expenditures, as normally defined, are the costs (usually in terms of foregone revenues) due to "special" provisions in the tax system which are designed to achieve identifiable social and economic objectives. Such programs are generally carried out through the provision of special exemptions, deductions, exclusions, credits and preferential rates in the tax system' (OECD, 1994, p. 144). This summary from the latest OECD discussion continues: 'In certain respects, the concept of tax expenditure is subjective and ambiguous in principle as well as in practice. The fundamental problem arises from the need to identify a suitable benchmark tax system, deviations from which should be treated as tax expenditures' (ibid).

The distinction between a tax expenditure and the provisions of the benchmark or normative structure of the tax system is argued to be central to the identification of a tax expenditure. 'The tax expenditure concept recognizes that a tax system contains two components which are conceptually and functionally distinct, though interwoven, in the tax law. One component contains those provisions necessary to implement the normative tax structure; the other contains those provisions - the tax expenditure provisions - whose function and effect are to implement government spending programs' (McDaniel & Surrey, 1985, p. 8).

In *Pathways to Tax Reform* in 1973 Surrey posed the distinction in a question: 'Which income tax rules are special provisions representing government expenditures made through the income tax

system to achieve various social and economic objectives and which income tax rules are just tax rules, that is, constitute the basic structure of an income tax system and thus are integral to having an income tax at all?' (Surrey, 1973, p.15). In a UK social policy journal Margaret Wilkinson provided a succinct answer: 'For an allowance to be judged as "structural" rather than an "expenditure", it must be general, applicable to everyone and to have no particular policy objective' (Wilkinson, 1986).

The main forms of tax relief are:

- Tax allowances - 'amounts deducted from gross income to arrive at taxable income' (OECD, 1984, p. 9). The standard basic allowance to which every taxpayer is entitled is one which is generally regarded part of the structural benchmark system. Additional allowances relating to marriage, dependent children or age are now generally accepted as tax expenditures. These are usually of a fixed amount.

- Tax exemptions - 'incomes or sources of income which are excluded from the tax base' (OECD, 1984, p. 9).

- Tax credits - 'amounts subtracted from tax liability which may or may not be permitted to exceed tax liability' - non-wastable or wastable respectively (OECD, 1984, p. 9). With a non-wastable tax credit any excess of the credit over the actual tax liable is paid to the taxpayer.

- Preferential tax rates - incomes or sources of income which are taxed at a lower rate than equivalent income or sources of income.

In their 1985 comparative survey McDaniel and Surrey discuss six ways in which a specific provision may be part of the normative tax structure and so not a tax expenditure (McDaniel & Surrey, 1985, p. 9; see, also, Nordiska Skatteutgiftsgruppen, 1987; OECD, 1984; 1996). However, as this report shows, comparative analysis brings out difficulties in maintaining a clear distinction between tax expenditures and other tax provisions. What is seen as the normative tax structure in one country may not correspond to the view in another. To enable comparison of the distribution of resources through the tax system in different countries it is often necessary to include elements of what that country's tax expenditure analysts might regard as part of the basic normative structure of the tax system.

Comparison with other countries can also reveal the extent to which fiscal welfare is built into the very structure of that country's tax system: in consequence it would not necessarily be included in any measurement of tax expenditures. This seems to be illustrated particularly clearly in identifying the tax unit in different countries. In fact, when they came to setting out the guidelines for the taxable unit, McDaniel and Surrey themselves decided that the treatment of the tax unit raised major questions and concluded that there could be no single position. A specific instance neglected in theirs and other work is the treatment of tax reliefs relating to children in the United States. According to the official published estimates there are none, and this is technically correct. However, each member of a household in the United States is given a basic tax allowance and these are summed before tax is charged. In consequence a tax unit with dependent children in that country pays less tax, all other things being equal, than one where there are no children.

In addition to the considerable problems of defining tax expenditures, there is also debate over the most appropriate form of measuring them (OECD,

1994, pp. 143-147). Three methods of calculating tax expenditures are usually considered: revenue foregone, outlay equivalent and revenue gain. The first is probably the most widely used and estimates the amount by which government revenue is reduced in relation to that particular tax measure. The outlay equivalent method seeks to calculate the amount the government would have to pay to individual taxpayers to leave them with the same net income as the tax relief. This results in higher, often much higher, estimates than the revenue foregone method and is generally regarded as harder to calculate. The revenue gain method estimates the extra revenue from removal of the tax expenditure. Unlike the other measures, it seeks to take account of consequential changes in economic activity and taxpayer behaviour. It is the most complex of the methods, and therefore least used outside the United States where technical analysis has probably advanced the furthest. More than one method may be used in official accounts.

The definition and measurement of the benefits of tax welfare have received much less attention than the tax expenditures. No governments make regular analysis of the beneficiaries of tax benefits according to gender, age, income or any other grouping as they now commonly do for cash benefits like social assistance and unemployment benefit. In principle, similar methods could be used for tax benefits as for cash benefits although in practice there may be important methodological problems as how to determine the utility of tax benefits for the individual according to his/her income and how priority should be given to the mix and value of tax and cash benefits. Different measures may be appropriate depending on whether the tax benefit or tax expenditure side of tax welfare is in focus.

The recognition of tax expenditures in Denmark and the United Kingdom

In the United Kingdom the government only made very reluctant steps towards recognising revenue losses through the tax system from the end of the 1970s (OECD, 1984, p. 68). Some data had been even more grudgingly provided from time to time in the 1970s. In 1979, under pressure from a parliamentary accounts committee, a list was included for the first time in the annual White Paper on public expenditure and this was continued until the early 1990s. (It was also reprinted with any revisions which had come to light in the Inland Revenue's annual statistical report.) The list, which was firmly called 'tax allowances and reliefs', grew longer but there was no evidence that the idea of tax expenditure as such had been incorporated into the government's spending strategy.

The first year the list was published the Treasury expressed particular reservations about the utility of the concept of tax expenditures, including reference to problems incurred in the United States. Similar views were put even more strongly to one of the authors in an interview with senior Treasury officials in the mid-1980s. However, it is clear that there was concern within the Treasury about the rising cost of some reliefs and allowances and there were policy changes.

The first sign that there was any official recognition of the concept of tax expenditure as such came in January 1993 when the title of the annual table was changed to "Tax expenditures and structural reliefs'. The latest list issued by the Treasury appears in the 1995 Inland Revenue Statistics (IR, 1995, Table 1.6). It is accompanied by an explanatory text:

'The effect of some tax reliefs is to help or encourage particular types of individuals, activities or products. Such reliefs are often an alternative to public expenditure, and have similar effects. They are therefore called "tax expenditures". Other reliefs serve a different purpose. They may, for example, allow for the costs incurred in generating income, or reflect the broad objectives of the tax, or be designed to simplify compliance or administration. Such reliefs are called "structural reliefs"' (IR, 1995, p. 8).

It is noteworthy that the table has now been dropped from the annual White Paper on Public Expenditure, underlining the government's reluctance to integrate planning on public and tax spending, despite the fact that measures have been taken to remove or reduce some tax benefits. The Inland Revenue report now carries two other tables: 'the cost of minor tax allowances and reliefs in force in 1993-94 or 1994-95' which cost less than £50 million each; and a similar list for those whose costs are not known (IR, 1995, tables B.1 and B.2).

In recent years the Treasury has itself issued what it calls the *Tax Ready Reckoner and Tax Reliefs*. It is not published in the sense that it has no price, is not listed in the government publication catalogue and has no ISBN or ISSN number. The July 1995 issue has fourteen pages, mainly of tables, some footnotes and a little text (Treasury, 1995). Its main purpose is to provide estimates of the effects of various illustrative tax changes. Since 1993 it has included a table on the 'estimated costs of principal tax expenditures and structural reliefs'. It contains a number of items not listed in the published tables of the Inland Revenue because they are not the responsibility of that Department but of the Department of Social Security (3 items of National Insurance Contributions) and the Customs and Excise (23 items of Value-Added Tax).

In Denmark, and in the Nordic Council of Ministers, recognition of tax expenditures have developed since the early 1980s out of an interest in the significance of the tax system for the size of public expenditure. There has been a particular focus on the costs of tax reliefs resulting from the non-taxation of social benefits. In 1982, NOSOSKO commissioned the Danish economists, Jørgen Søndergaard and Henning Sørensen, to assess the implications of the Nordic tax systems for cross-national studies of social security cash benefits. Their main conclusion was that the Nordic official statistics could not be directly compared (Søndergaard & Sørensen, 1983, p.7). Benefits for the individuals did not give a true picture because they did not take taxation into account - for example, the taxation of unemployment benefits and the tax exemption of most child family benefits. Similarly, the statistics did not give the real picture of the public costs, since no account was taken of revenue from the taxation of benefits or the loss of revenue from the non-taxation of benefits. The use of net estimates which took into account the different national tax systems' importance for cash benefits demonstrated that cross-national differences in expenditure were somewhat less than officially stated (ibid, p. 39).

The Nordic Council of Ministers also commissioned a study of tax expenditures in general which concluded that the Nordic governments were becoming increasingly aware of their existence in relation to the hidden subsidies of private companies and specific sectors of industry, but not in relation to the tax benefits for individuals (Nordiske Skatteutgiftsgruppen, 1987).

In 1989, the Danish Economic Council *(Det Økonomiske Råd)* made a detailed study of the impact of different national tax treatment of social security benefits for the level of public expenditure

in Denmark, Germany and the Netherlands. The main conclusion was that cross-national differences were much smaller than the regular, published statistics showed when differences in taxation were taken into account (Det Økonomiske Råd, 1989). In particular, the difference was reduced between Germany, which allowed old age pensions and unemployment benefits to be free of taxes, and Denmark and the Netherlands where these benefits were taxed, at least in part. This study was followed up two years later by Goul Andersen and Munk Christiansen in a comprehensive study of Danish public expenditures in an international context. By taking into account the differences in taxation of public benefits as well as the interest paid by the public sector on debt, the two researchers concluded that the 'real' differences between the three countries were much smaller than gross public expenditure accounts suggested (Goul Andersen & Munk Christiansen, 1991, pp. 41-49).

Meanwhile in 1990, the Ministry of Taxation was spurred on by a discussion of the relatively high Danish marginal tax rates to examine the role played by the tax base from which these rates are applied. The Ministry noted that 'if the tax base is eroded by considerable tax deductions or by certain types of income not being subject to income tax, then tax rates would normally be higher' and 'it has the same effect if the income tax base is made smaller through tax deductions or by making certain types of income exempt from tax' (Skatteministeriet, 1990, p. 136). Drawing on OECD material, including the 1990 study on income subject to tax and the studies on the Tax/Benefit Position of Average Production Workers, the Ministry made an international listing of the types of income subject to income taxation and also the tax allowances (see OECD, 1990a; 1990b). However, no attempt was made to estimate the size of tax expenditures and tax benefits in this exercise (for similar discussions, see also Skatteministeriet, 1994).

The most comprehensive Danish study on tax expenditure was published in 1993 under the title *Tax Expenditures in a Theoretical and Empirical Context* by Bent Greve. The study contains a theoretical discussion of tax expenditures and provides estimates for 1989 and 1990 of the scale of tax expenditures and the distribution of tax benefits. The first official use of the term 'tax expenditure' by the Danish government is to be found the following year in the statement from the Ministry of Finance, although only in brackets (Finansministeriet, 1994). However, the idea of tax subsidies and tax spending programmes have been acknowledged for somewhat longer (e.g., Finansministeriet, 1984).

The scale of tax expenditure

Despite the continuing debates and the limited visibility of tax expenditures in many countries, there is clear evidence that the extent of the tax spending can be very considerable. There are also considerable problems in specifying exactly how large the total of tax expenditures is in any one country, let alone in making comparisons between countries. Most tax expenditure figures are estimates and are made on the assumption that the tax system is changed in no other respect. The revenue foregone method of measurement 'assumes that there would be no change in the behaviour of the taxpayer or in economic activity were a particular tax preference to be repealed. Hence it is not possible to sum estimates for individual items' (OECD, 1994, p. 147). This position is frequently quoted but it only applies to a situation where one is wanting to

consider the repeal cost. 'No one asserts that budget outlays cannot be added to produce a total outlay figure even though the interaction effect described above exists' (Surrey & McDaniel, 1985, p. 53).

At the very least aggregation can provide a useful preliminary indication of the scale of funds affected by tax expenditures for making assessments of their use across countries. In a recent study Bent Greve has published data for the late 1980s or early 1990s on the total cost of tax expenditures for eleven OECD countries based both on published data and on his own calculations (Greve, 1994, Tables 1 and 2). The table below sets out the evidence provided by the individual countries or taken from OECD sources. It should be borne in mind that different practices in definition, measurement and publication are bound to affect any comparisons.

Taking all reservations into account, we can still get a rough picture of the significance of tax expenditure. In eight out of the eleven countries total tax expenditures were equivalent to more than ten per cent of total public expenditure (Table 1). In four of these the proportion was over one-fifth, and they included Denmark at 26% and the United Kingdom at 22%. Finland was by far the highest at 37%, well over one-third, with Ireland at 23%. The amounts involved were also substantial when compared to the total revenue brought in from all forms of taxation. All but two of the eleven countries had a tax expenditure equivalent to ten per cent or more of the total tax collected. The same four countries were clearly at the top: in Denmark, United Kingdom and Ireland the proportion was over one-quarter and in Finland it was nearly two-fifths. Related to gross domestic product the four countries again clearly outstripped the others on the data available. In Denmark tax spending was equivalent to 15% of GDP, just ahead of Finland, and the United Kingdom and Ireland were only a little below 10%. By Greve's own calculations of tax expenditure for the different countries the scale of the tax benefits also

Table 1. Tax expenditures in eleven countries in total and as a share of gross domestic product, total public sector expenditure and total tax revenue.

	Year	Tax expenditure in billions of national currency	% GDP	% total public sector expenditure	% total tax revenue
Australia	1991/92	13	4	13	11
Austria	1990	79	4	9	11
Canada	1989	30	5	10	13
Denmark	**1989**	**120**	**16**	**26**	**31**
Finland	1989	71	14	37	38
Germany	1990	35	1	3	4
Ireland	1989	2	10	23	26
Italy	1991	79	5	11	14
Sweden	1992	68	5	7	8
United Kingdom	**1990**	**51**	**9**	**22**	**25**
United States	1990	294	6	16	18

Source: Greve (1994), Table 2, figures rounded.

appear as a considerable cost to government against both public expenditure as a whole and social spending alone (Greve, 1994, Table 1, p. 208).

By all three measures tax spending in these four countries, including Denmark and the United Kingdom, appears proportionally very much larger than the United States which has generally been regarded as having the largest tax expenditure account. It would be valuable to examine the trends in tax spending within individual countries over time to see to what extent the base-broadening rhetoric of the 1980s tax reforms actually led to policies which significantly reduced its scale. In the United States the Federal Office of Tax Analysis estimated that the 1986 Tax Reform Act 'reduced aggregate tax expenditures by ... approximately 40% of what they would have been in 1988' (Neubig & Joulfaian, 1988, pp. 1-2). So, without these changes, it seems that the United States would have been among the other four, not outstripping them. It may be that there is a significant effect from the way in which the US benchmark includes the substantial amount that in other countries would appear as dependants' allowances.

However, apart from this speculation, the table raises a problem familiar to anyone trying to make cross-country comparisons dependent on each country's official data when there are no standard internationally accepted and applied measures. Perceptions of the scale of an issue within a country are very much affected by the extent to which data are easily available and part of public discussion, as tax expenditures have been in the United States, sporadically admittedly, but probably much more than in other countries. Equally, public scrutiny can lead to more cautious governmental accounting of what may be seen as politically sensitive, as for example in the measurement of poverty or unemployment in many countries.

Caution about the precise weight which can be given to aggregated data from different countries however does not allow us to dismiss the significance of tax spending, and therefore the benefits which flow from it. It should also be noted that, in those countries where more detail is available on the different elements of tax spending, the largest items on the tax expenditures lists tend to be those meeting needs identical or similar to those met by social security and other 'welfare state provision' (McDaniel & Surrey, 1985). This makes it all the more important that discussion of what Titmuss called fiscal welfare and Dich called concealed subsidies should be taken forward and considered in conjunction with the more publicly recognised programmes of the 'welfare state'. In the next part of the report we explore the available evidence on the extent, form and impact of fiscal welfare in Denmark and the United Kingdom.

The Danish and UK tax systems

The patterns of fiscal welfare through tax expenditures cannot be set out as neatly as public benefits and expenditures. As will become clear, in neither country has there been sufficient analysis of the scale and development of tax benefits to allow the tidy characterization of policies and their changes over time. Here we start to build up such a picture.

Taxes have been traditionally defined as 'compulsory transfers to the general government sector without any link between the payment and aquisition of services' (e.g., Danmarks Statistik, 1995a). In this sense, both countries have been raising taxes for centuries, both in kind and in cash. And in both countries the income tax system has a longer history than the modern welfare state. In the United

Kingdom locally raised parish relief to support the poor laws was increasingly supplemented by indirect taxes on a bewildering variety of items. Income tax was first introduced to finance the Napoleonic Wars when the generally regressive indirect taxes were proving insufficient - or at least could not be further raised in what the government saw as a highly volatile political situation immediately after the French Revolution. Revived temporarily in the 1840s, the income tax system became a permanent feature from the 1860s when the highest rates in the nineteenth century (7%) were quickly reached during the Crimean War against Russia. 'Effective progressivity' was not introduced until the start of the twentieth century when unearned income was also taxed more highly than earned income. During the two world wars tax rates once again soared and an increasingly large proportion of the labour force was drawn into the system.

In Denmark another story unfolds in the 18th century. Unlike imperial and industrial United Kingdom, Denmark was very much an agricultural society and the farmers an important class in society. Taxes were mainly raised at the level of local municipalities and parishes and were based on the value of the farmers' land *(hartkornsskatterne)*. This revenue was used to finance, among other things, poverty relief. Local authorities had the duty to provide poverty relief as stipulated explicitly in the regulations in 1802 and 1803 for country towns and land districts just as poor people got the right to support. As early as 1835 farmers wanted to shift the burden of financing poverty relief from the corn taxes to the state level, and, thus, to direct and indirect taxes on income (Dich, 1973). The farmers' political party in Parliament, the Liberals, also pursued this way of thinking in social policy and only two years after the introduction of the 'new' Parliament in 1901 the first law on income tax was passed.

Another important factor contributing to the Danish Liberals pro-state social policy attitude was the 'corn sale crisis', i.e. falling corn prices resulting from corn imports from Russia and the United States starting in the 1870s. The crisis was a major one due to the agricultural base of the Danish economy. Furthermore, it became clear to Danish farmers that the risk of poverty was not only a question of individual behaviour, but was also related to conditions over which the individual had no control. In addition, workers migrated to the towns and to the New World where they could obtain higher wages than most farmers could afford. Liberals therefore promoted social reforms linked to state subsidies, implying income taxes, to serve the dual objectives of discouraging labour migration and easing the economic burdens on farmers (Petersen, 1985). In *The Ruling Class*, a study of the development of Danish social policy, Dich (1973) concluded that '... the social legislation in the last century and up till 1929, perhaps even to the Second World War, can be seen as the result of the farmers' efforts to free themselves from the expenditures going to poverty relief and in this way to reduce taxes' (Dich, 1973, p. 24). As this study brings out, interest groups and political parties have been well aware of the costs and benefits of the tax system since its inception as well as the tax system's intimate relationship to social policies.

Since 1945 the proportion of all UK government revenue raised from income tax has fallen from around one-third to about one-quarter in recent years. Another sixth is collected as National Insurance contributions from employers and employees, and about the same proportion from the main indirect tax, Value-Added Tax (VAT). The take of both of these has risen substantially since the war. In Denmark, revenue from direct and indirect taxes was virtually equal in 1948. The share of

direct taxes has risen since and in the 1990s provided three-fifths of all government revenue (Danmarks Statistik, 1995b).

The UK Conservative government reduced the top rates of income tax from 83% to 60% as soon as they were elected in 1979, and then again to a single higher rate of 40% in 1988. However, even under Labour the very great majority of all taxpayers were only paying tax at the standard or reduced rate. The standard rate rose to 33% in the late 1970s but has been brought down to 25% with a reduced rate of 20%. As governments failed to lift the tax threshold in line with inflation, more and more workers have been brought into the tax system, and in 1995/6 some 26 million people in a total population of 56 million will be paying some income tax. The unit of taxation remained the household until 1990 when husbands and wives were taxed separately.

In Denmark income taxes are collected by the state, counties and municipalities. The average tax on a person's taxable income collected by local government, i.e. counties and municipalities, has risen from 27% in 1984 to 30% in 1995 (Danmarks Statistik, 1995a). The state tax scale is progressive with three tax rates applying to different income brackets with an upper ceiling *(det skrå skatteloft)*. Moreover, there are also personal allowances in both the local and central government taxes, and until 1987 these depended upon the person's age and marital status. However, these personal allowances were deliberately set so low as to include most wage earners. thereby avoiding a split in the population between 'payers' and 'beneficiaries'. The notable exception were the old age pensioners who enjoyed specially increased personal allowances, which, in effect, left their national old age pension exempt of tax.

Although the taxes of the Napoleonic Wars in the United Kingdom barely survived the end of the Wars, much of the basic structure of the early acts has survived to the present day, and many of the reliefs and allowances were introduced in them. With successive reforms tending to build on rather than replace the existing system, the most widely recognised textbook on the subject comments:

'The present state of the British tax system is the product of a series of unsystematic and ad hoc measures, many undertaken for excellent reasons ... but whose over-all effect has been to deprive the system of any consistent rationale or coherent structure' (Kay & King, 1983, p. 18; reinforced by Steinmo, 1993, p. 44, who says its 'instability results in a pattern of fiscal incoherence'). The pattern appears similar in Denmark where such comments have been common (e.g., Dich, 1973).

The recent developments in tax expenditures and tax benefits

In recent years there have been more changes to the form and extent of tax expenditures and benefits than for many years previously. An analysis of these changes reveals the increasing, though still limited, recognition of the ways in which tax expenditures operate and the costs as well as benefits which they bring.

In Denmark relatively high marginal tax rates sparked off an increased interest in reforming the tax system (see, for example, Skatteministeriet, 1990; 1991) with two major tax reforms within the last decade. The first, implemented in 1987, introduced a distinction between personal income (primarily income from work and social benefits) and capital income (such as income accruing from interest and dividend). The splitting-up resulted in personal income being taxed progressively whereas

capital income was taxed proportionally, typically around 50%. After the reform, tax deductions were 'only' deductible in the capital income part at around 50% and not at the typically higher rate in the personal income. This allowed marginal tax rates to be lowered from 72% to 68%. However, contributions for pension purposes remained fully deductible in personal income, i.e. at the marginal tax rate.

The second tax reform, announced in 1993, is to be phased in over the five years 1994-1998, very much in line with the 1987 reform. The declared purposes of this reform are to:

- secure as far as possible the same tax treatment of all forms of income
- reduce speculation in taxes through abolishing tax allowances
- broaden the tax base to reduce marginal tax rates on income from labour
- make the costs of labour market measures more publicly visible by the introduction of a 'labour market contribution'

To achieve this, the reform altered the tax rules and rates, introduced the new labour market contribution for labour market measures, abolished and reduced a series of tax allowances, and made a tax/benefit reform involving social assistance and the social pensions, i.e. the national old age pension and the disability pension.

These reforms have led to a changed pattern of tax welfare, and, possibly, to a reduction in the scope of tax expenditures. Of particular relevance to this analysis are:

- the abolition of the increased personal allowances for pensioners which was more than fully compensated through benefit increases
- the removal of tax-exempt status for social assistance with a corresponding increase in benefits
- the reduction of marginal tax rates

The last change has meant a consequential fall in the cost of tax expenditures including those on pension contributions as their tax value decreased with the reduced marginal tax rate. However, these may have been more than cancelled out by the even lower marginal tax rates for pensions in payment to people who have already benefited from the tax relief on their reductions in tax rates. In consequence they have gained even more from the reduction in tax rates.

The impact of the two Danish tax reforms has been not only to reduce marginal tax rates, but also to make the social security system more coherent and transparent by taking the divergent tax treatment of social benefits into account. This had been strongly advocated by various committees (see, for example, Socialministeriet, 1991; Socialkommissionen, 1992). In particular, there was an all party agreement to make social assistance and social pensions (i.e. the national old age and disability pensions) comparable to other social security cash benefits. When making these benefits taxable, it was explicitly said that the purpose was not to reduce benefits. The monthly level of the guaranteed national old age pension for a single person was raised from 4,851 DKK in 1993 to 7,356 DKK in 1994. Similarly, social assistance for a single person without dependants was raised from a monthly amount of 2,909 DKK in 1993 to 5,546 DKK in 1994.

Unlike Denmark, the United Kingdom has not experienced any major tax reforms specifically related to tax benefits, although the reductions in

tax rates will also have reduced their value. The main policy changes to tax benefits began in the area which was most under attack from the 1960s - the persistence of a child tax allowance from 1910 as well as a less generous and more restricted public benefit, Family Allowance, from 1946. After much campaigning, the two schemes were finally merged by the Labour government in the mid-1970s into one public expenditure benefit which was exempt from tax (for similar discussions in Denmark, see Knudsen, 1987). Ironically, the new public scheme was introduced just after tax allowances began to be regularly indexed to increases in the cost of living. Treated fully as public spending, child benefit was often frozen in value, while tax thresholds were raised much more (McCarthy, 1986).

In the 1980s there was much more public attention to the tax relief for homebuyers. Until 1963 homeowners had been subject to a tax on the imputed value of their homes. When this was dropped with all party consent, tax relief on the interest paid on mortgages became a distinctly more attractive incentive to home ownership. In 1974 this was increased when all relief for interest on new non-business loans except for the purchase of one's own home was finally stopped. However a ceiling was set to limit the relief on home loans to interest on £25,000 (Willis & Hardwick, 1978, chapter 5).

As the Conservative government took many measures to increase home ownership in the early 1980s, the cost of this tax expenditure grew very significantly, almost trebling in real terms within the decade (IR, 1995, chapter 5). Recognition of this growth was all the greater because part of the government's stimulus to home ownership had been to force up public housing rents so that few, if any, local authorities made any subsidy to council house rents. Over the first ten years the Conservative government was in office, public spending on public housing actually fell in absolute terms by £0.7 billion to £3.7 billion while the cost of tax help for owner-occupiers rose from £1.1 billion to £7 billion (IR, 1995, chapter 5).

In 1988 the reduction of the top rates of tax from a range from 35% to 60% to a single higher rate of 40% and of the standard rate from 27% to 25% were measures which in themselves reduced the cost of tax expenditures considerably. The government also used the general reduction to remove some relatively small tax reliefs and to limit one large one, but in a relatively small way. The National Audit Office and the parliamentary Public Accounts Committee had criticised the level of scrutiny which was given to loans raised for home improvements and extensions which attracted interest relief (CPA, 1986). The Bank of England had also published data on the extent of abuse (BEQB, 1986). Relief was removed for any future loans for these purposes and in addition mortgage interest relief was limited to one loan per property. The extent of these restrictions was fairly small as a proportion of the total cost, but it did indicate the government's concern with this item.

The gulf between public and tax spending at that time is well illustrated by the fact that child benefit had come under significant attack as 'wasteful' because it went to all children and not just the poorest. However, the virtues of 'targeting' were not considered relevant to the tax system and there was no such criticism of married man's allowance, a tax benefit, which was equally available to all married couples and was paid whether or not they had children - and in fact cost the government about as much as child benefit. While the government argued that it was forced to cut back social security benefits because of economic pressures, its reform of the taxation of husband and wife did not reduce the cost of that tax benefit and apparently paid no attention

whatsoever to its relation to child benefit which it then froze for three years.

However, in the 1991 Budget the significance of the scale of tax reliefs and their interchangeability with items of public spending was explicitly recognised. The Chancellor of the Exchequer froze the value of what was now the married couple's allowance 'to use the resources released' to increase child benefit. 'It goes to all families; to the children of non-taxpayers as well as the children of taxpayers' (Budget Speech, *Financial Times*, 21 March 1991, p.20).

Changes in government tax policy since then reveal that there is now continuing attention to the cost of tax reliefs. Two major reliefs have been significantly reduced. In 1991 mortgage interest relief was limited to the standard, and not the higher, rate, saving some half a billion pounds, and in 1993 further reductions were announced for that and the married couple's allowance. In successive years the value of these reliefs has been restricted to the reduced rate of 20%, and then to 15%, effectively reducing them to wastable tax credits.

Recent changes therefore indicate an increasing awareness of the costs of tax expenditures. This has probably intensified in the last three or four years as the significance of these benefits for reducing the budget deficit seems at last to have been recognised. It is sometimes said in discussion that the Treasury is opposed to tax expenditures, with the addition that it is only the political leaders who insist on keeping them. However, the lack of detailed data and public discussion makes it difficult to be more precise on what strategies are being considered.

On the other hand, there are some grounds for thinking that there is now tighter surveillance and control at least of the total costs involved. In recent years new tax expenditures of quite significant amounts have appeared in the published list, and these indicate in some areas an increase or at least a persistence in tax spending. Whether this is evidence of a relaxed attitude to the costs or a small step to raising their visibility with a view to controlling them is not yet clear. The cost of exempting child benefit from tax (£650 million in 1994-95) has begun to be published although this relief has been available since the end of the 1970s and apparently easily capable of being calculated - perhaps a prelude to taxing the benefit without any corresponding increase in the benefit.

Another example is provided by the exemption from tax of the first £30,000 of any payments someone may receive on the termination of employment. In the three years of published data, the cost appeared to have risen by 60% to £1.6 billion (IR, 1995, Table 1.6 and earlier years) - some £300 million more than public spending on what is intended to be the main benefit for people out of work, National Insurance unemployment benefit. This is limited to the involuntarily unemployed while there is no such restriction on the tax benefit which may simply provide relief for a redundancy payment but may also help employers to persuade staff and management to leave for other reasons or to take early retirement. The cost of the public benefit will be cut by half as the government replaces it with the Jobseeker's Allowance which reduces the duration of the insurance benefit from twelve to six months in April 1996. The full year's unemployment benefit for a single person is £2,415 and for a couple £3,905, and is taxable: the tax benefit is worth up to £7,500 for a standard rate taxpayer and up to £12,000 for a higher rate taxpayer with no requirement that the person remains out of work.

Clearly there is still considerable inconsistency in tax expenditure policy, or perhaps it would be more correct to say that individual tax benefits are considered individually and there is still no overall

policy relating to them. However, it is now clear in relation to tax expenditures and benefits that governments have made a very much more conscious use of individual measures to promote government strategies. In the United Kingdom, allowing the cost of mortgage interest relief to grow in the 1980s is one indication: the encouragement of personal pensions and private health insurance for people over sixty years old are others within the traditional social welfare field. Schemes for profit-related pay, profit-sharing, share-options and various forms of savings also provide examples. In Denmark, the strategy in recent years seems to have been the reduction of marginal tax rates and tax reliefs as well as the general trend of making social security cash benefits taxable. Clearly, governments are aware of the political significance even when so little attention appears to be paid in formal policy-making. Changes in schemes are very carefully timed, with restraints usually just after elections and innovations or expansions tending to precede them.

Tax benefits in Denmark and the United Kingdom

Despite the many changes of the national tax systems in recent years there are still a considerable number of tax benefits in the two countries. Overview 1 illustrates some of the similarities and differences. Although there are two areas where there are no reliefs, the lists are more notable for the different ways in which relief is provided. The greatest contrast is that most Danish tax benefits are only allowed against the amount of tax to be paid while most UK tax reliefs are still set against taxable income.

In Denmark many would not include the relief on loan interest since this is available for all loans. From a Danish perspective this is generally seen as a necessary symmetry of taxation to prevent substitution between various types of loans and savings. This symmetry of taxation is seen as essential to stop people from speculating in the tax system with regard to loans. However, the comparison between the two countries makes it important to recognise that this assistance to home ownership exists and without any of the limitations to the scope and extent of the relief now applying in the United Kingdom.

The fact that contributions to unemployment insurance are deductible in Denmark while National Insurance contributions are not in the United Kingdom may well reflect the fact that Danish trade unions continue to have a stake in the national unemployment insurance scheme which is organised and administered by them whilst this possibility ended in the United Kingdom in 1948. However, it could also be argued that contributions to the unemployment insurance are deductible because they are part of securing an income and so should be treated as part of the normative tax system and not a tax benefit. In the United Kingdom, contributions to unemployment insurance are not deductible; instead 'golden handshakes' are promoted in the tax system.

Both countries encourage the promotion of private pension provision, although in different ways, and give help to families in the form of tax-exempt benefits (for a discussion of pensions, see below p. 30). There are no tax benefits in either country for maternity or short-term sickness. Need or poverty, which is often regarded as the main concern of public programmes of social security is not recognised except perhaps in the setting of the basic allowance.

Overview 1. Examples of tax benefits in Denmark and the United Kingdom by area of social protection, 1996.

	Denmark	United Kingdom
Unemployment	Tax-deductible contributions to Unemployment insurance	Tax-free payment on termination of employment (ceiling £30,000)
Sickness & health care	-	Tax-deductible premiums on private health insurance for those over 60
Maternity	-	-
Disability	Tax-free Personal supplements to Disability pension	Tax-free Incapacity benefit Tax-free Attendance allowance
Old age & survivors	Tax-free Personal supplements to National old age pension Tax-deductible contributions to private retirement provision (annual ceiling 31,200 DKK) Preferential tax rate of 40% for Capital pension lump sums	Tax-deductible contributions to occupational and personal pensions (with ceiling) Tax-free income to approved pension funds Tax-free occupational and personal pension lump sums (with ceiling) Tax allowance for old age
Family	Tax-free Child family allowance Tax-free Child allowance Tax-deductible Alimony for contributor Tax-free Alimony for recipient	Tax allowance for married couples Tax allowance for one-parent family Tax-free Child benefit Tax-free One-parent benefit
Need	-	-
Housing	Reduced imputed value of own housing for old age people Tax-deductible interest on loans as part of general relief for interest on all loans	Tax-deductible interest on loans for purchase of own home only (max. £30,000)

Source: Ploug & Kvist (1994); and updates.

Note: See page 40 for translations of various schemes. Certain tax benefits for housing purposes not included, although they play an important role in both countries via, for example, tax-free housing benefits (in Denmark, in particular, for families, elderly and people in need).

The cost of tax expenditures in Denmark and the United Kingdom

Denmark and the United Kingdom were among the big tax spenders in Table 1. A more detailed picture for the United Kingdom emerges from table 2 below which shows the change in the estimated cost of some major tax reliefs between 1978-79 and 1994-95 in real terms. (Over the same period total public expenditure increased by 21% in real terms). The largest items in the published list are mainly ones relating to social welfare - for pensions and retirement, for married couples, for home-buying, for job loss and for exemption of some mainly long-term social security benefits. In the early 1980s the tax exempt status of social security benefits was generally removed, except for child benefit and the longterm invalidity and disability benefits included here.

In 1994-95 the tax benefits in the table accounted for roughly one-quarter of the cost of the 54 items in the whole list, and for over four-fifths of the 31 purely income tax reliefs excluding the basic personal allowance available to every taxpayer.

As mentioned earlier there is no tradition in Denmark for the regular estimation and publication

Table 2. Major Tax Allowances and Reliefs related to Social Policy, United Kingdom, 1978-1995, estimates in £ millions (1990 prices).

	1978/79	1981/82	1985/86	1989/90	1991/92	1994/95
Allowances:						
Married couple's allowance	n.p.	n.p.	5,556+	5,000+	4,394	2,987
Age-related allowance	724	639	590	500	650	619
Additional allowance for one-parent family	175	189	208	202	252	222
Reliefs for:						
Occupational Pension Schemes	1,248	1,639	11,250	8,191	7,196	5,974
Self-employed Annuities & Personal Pensions	275	508	451	1,064	1,402	1,621
Life Insurance Premiums	1,073	869	889	404	280	154
Mortgage Interest	3,620	3,328	6,597	7,340	5,701	2,987
Exemptions:						
Child benefit & one-parent benefit	n.p.	n.p.	n.p.	n.p.	n.p.	555
Longterm disability benefits	412	320	375	824	729	1,357
First £30,000 payments on termination of employment	n.p.	n.p.	n.p.	n.p.	n.p.	1,365

Sources: IR and Public Expenditure White Papers, relevant years, on basis of revenue foregone.
Note: n.p. - not published.

of tax expenditures. Instead use is made of *ad hoc* investigations on selected issues, e.g., on the taxation of social assistance and social pensions (Socialministeriet, 1991). The only comprehensive study estimated that for 1989 the total amount of tax expenditures came to some 120 billion DKK which could reduce gross taxes by nearly 60% if they were all abolished. However, as the author points out, this is a gross estimate taking a narrow definition of the normal tax structure and not taking into account any changes in behaviour (Greve, 1993). The amount of tax expenditure today will be somewhat smaller due to the recent changes in the tax system, and the major conversion of housing loans with high interest rates to loans with lower interest rates. Nevertheless, the study illustrates the potential magnitude of tax expenditures, where deductions for contributions to old age pensions constituted the single second biggest element after the deduction of interests on all loans.

The distribution of the benefits of tax expenditures

There is one particular shortcoming of aggregate estimates. They do not allow us to compare who gets what by different income-levels within countries, let alone between them. As this section demonstrates, knowing more about the distribution of tax benefits is important for public policy analysis.

Many tax allowances operate at the marginal rate. In consequence the higher the rate of tax that the individual is paying, the greater the value of the allowance. As a result Stanley Surrey pointed out that tax expenditures have an 'upside-down effect' (Surrey, 1973, p. 37). Given the emphasis in many policy analyses on securing adequately 'targeted' benefits which only reach those who are in the greatest need, tax benefits of this form may be described as examples of 'inverse' or 'reverse targeting'. They go most generously to those who have most resources and could therefore be regarded as needing them the least.

It is important to recognise that such an upside-down effect is not inevitable. Tax benefits can be made available against the tax to be paid rather than against taxable income so that all taxpayers benefit by the same amount. It can also be paid to those who do not have enough taxable income to take advantage of the whole amount of the credit - what is called a 'non-wastable' or 'refundable' credit.

The different outcome between the upside-down effect of allowances which can be set against the highest rate of tax and a tax credit is nicely illustrated by the changes to the married couple's tax allowance in the United Kingdom in recent years (Example 1). A tax benefit which had been allowed at the highest marginal rate of tax since 1920 was limited in successive years to the lowest rate of tax paid (20%) and was then reduced below that to 15% of its value. In the second and third years it operated as a tax credit and was equivalent to paying everyone claiming a married couple's allowance a fixed amount as a public benefit - but with one important qualification. It only reached those who had a high enough taxable income: it was not refunded to those whose incomes were too low to reach that level, although this could have been arranged.

The upside-down advantages of tax benefits may be further increased by the fact that people with higher incomes have more money to allocate to purposes which attract tax relief. This is particularly beneficial where there is no ceiling on the amount which may be used in that way, or the limit is set so high that it does not affect most people.

Example 1. Value of £1,720 tax benefit for married couples, £ per year.

	1993	1994	1995
to 40% taxpayer	688	344	258
to 25% taxpayer	430	344	258
to 20% taxpayer	344	344	258
limited to 15% for all	-	-	258

One question deserves further consideration than we give it here: are the direct recipients the only or the real beneficiaries of tax expenditures? Tax experts have no hesitation in discussing this question in relation to the imposition of taxes. For example, the very first chapter of *The British Tax System* by John Kay and Mervyn King, probably the most highly-regarded textbook on the subject, begins: 'Economists have been concerned with the question of who actually pays any particular tax - the incidence of the tax'. After devoting four pages to this issue, it concludes that 'the first principle - the irrelevance of formal incidence ... has some wide-ranging implications' (1990, fifth ed., pp. 6 and 9).

Applying that first principle to the incidence of the tax benefits of fiscal welfare is not easy but seems important. It might seem at first sight that child tax allowances would be good examples of where the formal and effective incidence are likely to be much the same. However, it has been argued that a child benefit paid directly to the mother is more likely to be spent on the child, while a child tax allowance which simply results in the adjustment of the net pay of a worker, usually a man, just disappears into the generality of their income. This was a point very vigorously put in the United Kingdom in the 1970s and again in the 1980s when there were proposals to pay family benefits through the wage packet.

The hidden subsidies to provision for retirement

Comparative evidence indicates that the most costly categories of tax benefits in most countries are related to retirement and the encouragement to establish pension entitlement as an alternative or addition to state provision. OECD has drawn attention to the particularly favourable treatment of pension schemes in most countries, and Denmark and the United Kingdom are shown as providing especially generous arrangements. 'If the pension tax expenditures could be added together, ... the revenue cost of the incentives to save via pension plans ... would sum to around 15 per cent of personal income tax revenues in the United Kingdom', apparently the highest proportion of the 24 member countries surveyed (OECD, 1994, p. 155). The cost of tax expenditures for pensions in the United Kingdom far exceeds the cost of any others, and in Denmark it is probably the second most expensive element (Greve, 1993). A more detailed analysis demonstrates the importance of these and other benefits for providing support in retirement and the irrationality of not integrating them with public spending programmes in policymaking.

In principle, tax relief can be applied to both public and private pension schemes. In practice, private pensions can receive much more promotion from the availability of tax reliefs at one or more of the points of transaction which constitute most occupational pension schemes (see overview 2).

Most countries give more than one type of tax relief for private pensions (OECD, 1992; Kvist, 1992) whereas public pensions 'only' enjoy tax relief in payment *via* age-related tax allowances. For example in the United Kingdom, the age allowance helps the majority of people when they are retired. Some form of age allowance has been available

Overview 2. Possible tax reliefs for private pensions according to point of transaction and beneficiary.

Point of transaction	Actor	Possible tax reliefs
Contribution	Employee Employer	Deductible
Income from pension investment	Fund	Tax-exempt Preferential tax rate
Pension in payment	Pensioner	Preferential tax rate Tax-exempt Age-related allowance

since the late 1950s and it was made more generous in the 1970s, giving people over the age of 65 a tax threshold one-fifth higher than the basic allowance. This is phased out so that it does not benefit older people with high incomes, but it is equally of no value to the large number of people past retirement age who are wholly dependent on limited state benefits. The cost of this tax benefit was £725 million in 1994-95, expected to have risen to almost £1 billion by the following year (IR, 1995, Table 1.6). In Denmark, as described earlier, the abolition of the increased allowance for the aged was part of the 1994 tax reform and pensioners were compensated through considerable benefit increases. These now show up as increased welfare spending although individual net welfare has not increased accordingly. Only the route to welfare has changed.

In both countries there is much private provision for retirement to supplement or substitute for state-organised schemes. The most important is the company or occupational pension, the main alternative for employees to the state pension scheme. The attractions of life assurance have been reduced in the United Kingdom since 1984 when tax relief was removed from all new policies, but life assurance in Denmark receives as generous reliefs as saving for pensions.

In the United Kingdom there are four main reliefs for all occupational pension schemes which meet the requirements for approval:

- contributions by employees are deductible for income tax purposes up to a ceiling;
- contributions by employers do not count for income tax purposes as payments to employees and are deductible as an expense by the employer for income or corporation tax purposes;
- income and gains from investments are not subject to income and capital gains taxes;
- lump sum retirement benefits are not subject to income tax up to a ceiling.

Tax relief on employees' contribution is particularly valued by workers as there is no relief for the contributions to the state's National Insurance scheme, and these may also be reduced by joining an occupational scheme (see below).

The Danish situation is different on the last two points. Firstly, pension fund income from investment in Denmark is taxed through a 'real interest rate' *(realrenteafgiften)*, which in effect taxes all income above an annual rate of 3.5% at a 100%, although exemptions are made for certain types of investment. In 1994, revenue from the real interest rate amounted to 25.6 billion DKK equal to 5.6% of total revenue and more than the revenue raised from either company taxes (3.7%) or property taxes (2.3%) (Danmarks Statistik, 1995a). Secondly, lump sum payments from capital pensions are not tax exempt as in the United Kingdom, but taxed at 40%. However, this can be considered a preferential tax rate since 40% is typically below the marginal rate of personal income taxation at the time of contribution to the fund.

Table 3. Illustration of the pension tax regimes in Denmark and the United Kingdom.

	Denmark	United Kingdom
Contributions	100	100
Fund income	100	100
Net income	43.56	61.05
Fund at retirement	143.56	161.05
Tax on withdrawal	35.89	40.26
Benefit withdrawal	107.67	120.79

Source: Extracted from Dilnot (1992), Table 5.1 with Denmark and the United Kingdom approximating columns D and A respectively.

Note: Assumes a single income tax rate of 25% and a rate of return on investments of 10%, and with a single contribution from earned income of 100, five years before retirement.

The differences in the taxation of private pensions obviously affect their attractiveness to tax payers, individual or corporate, and this will influence their takeup, the level of contributions, their eventual value and who benefits most, as well as the overall cost of the tax subsidies. An illustration of their different effects upon the final pension can be seen in Table 3 which provides a simplified model of their working (see note to table). It shows a greater advantage to pensioners from the UK system which is even larger if allowance is also made for the opportunity to take a substantial lump sum tax free.

In Denmark, the cost of these tax reliefs has not been routinely monitored but left to *ad hoc* evaluations (see, for example, Vesterø Jensen, 1985; Greve, 1993). For example, in *Pension Saving Coverage and Compensation*, the latest pension study by the Ministry of Finance, only a nine page appendix was devoted to discussing whether tax rules subsidised savings for old age (Finansministeriet *et al*, 1995, annex 3). The Ministry argued that it was not necessary to estimate the cost of tax reliefs since taxation was simply being postponed, adding that the 'size of (tax) subsidies depends among other things on the historical rates for deductions for pension contributions in relation to the actual tax rates at the time of payment' (Finansministeriet *et al*, 1995, Annex 3, p. 8). However, the preferential rate of capital pension lump sums and the exemptions to the real interest rate were acknowledged to be deviations from normal taxation.

In the United Kingdom, although the estimated cost of these reliefs was revised upwards in the mid-1980s, the Conservative government focussed on the future cost of the state's pension schemes in its Social Security Review, giving the tax subsidy to non-state pensions only one paragraph in the four volumes of the government's Green Paper on the reforms (DHSS, 1985). The review resulted, first in unsuccessful proposals to abolish the State Earnings Related Pension Scheme (SERPS), and then in its severe cutback in the 1986 Social Security Act, and again, more recently, in the 1995 Social Security Act. And the 1986 Act introduced a new form of

private pension for employees, called the 'personal pension', which encouraged people to take it out with both income tax and National Insurance subsidies. The tax reliefs for these rose swiftly, approaching £2 billion by 1994-95 (IR, 1995, Table 1.6).

Further revised estimates of the tax expenditure have received sporadic attention, with charges of both over and understatement of the actual cost (see, for example, IFS, 1993, p. 5). In 1994-95 the net total for occupational and personal tax expenditures was about £9 billion even after deducting the tax raised on pensions in payment (IR, 1995, Table 7.10). Lack of information has meant that certain elements of the cost cannot be included. In 1985 there was much talk of the taxing of the lumpsum. The Chancellor of the Exchequer raised the possibility but, as he reports in his memoirs, he was defeated by a concerted and successful campaign against it (Lawson, 1992). But the government has made limited changes to the tax reliefs, one of which limits the maximum benefit that can be obtained.

There are other subsidies for those taking out occupational or other private pensions - rebates or incentives provided through the National Insurance scheme. The great majority of occupational pension schemes opted to 'contract-out' of the state National Insurance scheme in return for members giving up the main earnings-related element of the state pension when they retire. In consequence contributors, employers and employees, currently pay little more than half the NI contribution they would otherwise do to maintain employees' entitlement to the basic state pension and the other NI benefits for unemployment, incapacity to work, etc. The cost of this rebate has been over £7 billion a year for some years (Treasury, 1995, Table 10). The Treasury treats this as equivalent to a structural relief because those 'contracted-out' receive smaller National Insurance pensions, and so cost the NI scheme less.

For seven years, however, an additional National Insurance incentive was introduced to encourage people to take out the new personal pensions. As well as allowing reduced NI contributions, the government actually transferred a significant proportion of the remaining NI contribution directly to the new pension at the cost of some £0.8 billion a year. Since 1993 the incentive has been halved and limited to contributors aged 30 and over, with the cost falling considerably (Treasury, 1995, Table 10 and earlier years).

The total amount of funds that are rerouted to support non-state pensions can be seen to be very considerable. As far as we have been able to establish, these two sets of accounts are treated quite separately. They are the concerns of different government departments and policy changes in each, or proposals for change, do not appear to take account of the other expenditures. Questions on whether the success of the programmes is assessed taking account of both sets of costs together are met with puzzlement: they are clearly seen as different areas. While it is often argued that National Insurance contributions are simply another form of taxation and therefore should be treated as such, their 'reliefs' are not regarded in the same way.

The distributional effect of these very substantial tax and tax-related reliefs also deserves careful consideration, and it is remarkable how little discussion of this there is in either country. The first issue is who is able to gain an occupational pension or can afford to arrange a private pension independently. We are able to get a better picture of changes over time because of the major comparative study carried out in the 1960s by social scientists in Denmark, the United Kingdom and the United States (Østergård, 1965; Asmussen & Jørgensen, 1966; Shanas, 1968; Shanas *et al*, 1968). Using identical questionnaires they found that more people were covered by occupational pensions in the United

Kingdom than in Denmark, but that the income derived from these pensions was higher in Denmark (Shanas *et al*, 1968, p. 359-362). This was because occupational pensions in Denmark were then largely confined to white collar workers (Shanas *et al*, 1968, p. 363) and especially to public employees. However, the pattern of occupational pensions in the two countries have been changing and the tax system has had a major role to play in this transition.

Until the late 1980s the company or occupational pension in the United Kingdom was the main alternative to state pensions for employees. In 1953 well over a quarter of all employees were members of occupational pension schemes and by 1967 well over a half (53%). It has remained around that level or a little lower since then, with 48% membership in the latest government survey in 1991 (Table 4).

Table 4. Membership of occupational pensions in the United Kingdom, 1983, 1987 and 1991.

	1983	1987	1991
Members, total in millions	11.1	10.6	10.7
Coverage, % of employed	52	49	48
Women members, total in millions	3.3	3.4	3.4
Coverage, % of female employed	37	35	37
Men members, total in millions	7.8	7.2	6.8
Coverage, % of male employed	64	60	57

Sources: Government Actuary (1987; 1991; 1994).

Since 1988 in the United Kingdom there has been more growth in the new individual personal pension plans supported by extensive tax and tax-related reliefs. Group schemes are also developing in this form and most new occupational schemes are contribution rather than benefit defined. In contrast, in Denmark the supplementary pension system has been transformed towards more collective responsibility in the form of new occupational pension schemes based on collective agreements in the late 1980s and early 1990s. This move was also supported by the tax system, although not as explicitly as in the United Kingdom and without monitoring the costs.

Table 5. The coverage of occupational pensions in Denmark, end of 1993.

Schemes	Members
Civil servants	227,000
Firm level	260,000
Collective agreements, pre '89 schemes	307,000
Collective agreements, post '89 schemes	567,000
Total	1,361,000
Total as % of full time employed	63

Source: Finansministeriet *et al* (1995).

Note: Another 200,000 were estimated to be covered by occupational pensions but at the time subject to waiting rules.

In 1993 more than three out of five full-time workers in Denmark were covered by occupational pensions (Table 5). In the latest survey by the Danish National Institute of Social Research an even higher figure for coverage was found for 1994. Sixtynine per cent have an occupational pension as part of their work contract (unpublished material from the European Community Household Panel), eighty per cent of public employees as compared to 59% of those in the private sector. Seventyone per cent of women are covered compared to 66% of men which can be attributed to the greater share of women working in the public sector where occupational pensions are widespread (ibid). And the Ministry of Finance expects that 85-90% of all people will be covered by an occupational pension during their working life (Finansministeriet *et al*, 1995, p. 21).

The Danish supplementary pension system has in other words been transformed since the study of the 1960s. Occupational pensions are no longer the sole property of the public employed but are also held by private employed, both white and blue collar workers (for a discussion, see Petersen, 1995). So nearly the whole working population seems to enjoy fiscal privileges although of course to a different extent. There is great intragenerational inequalities between, for example, the tax benefits for non-skilled female workers in one of the new schemes and white collar workers in the old schemes. The development of this part of the hidden welfare state in Denmark in recent years can thus be seen as a process of both universalisation and polarisation at the same time. The impact of this on the national old age pension is yet to be seen.

In the United Kingdom, in recent years many problems have emerged with private pensions, both occupational and personal. The misuse and loss of occupational pension funds discovered after the death of Robert Maxwell led to the subsequent realisation of many more problems with these pensions requiring new government legislation and this has been criticised by many for being too weak. Anxiety over company pensions created a more favourable market for the new personal pensions (Waine, 1996). Some eight times more people subscribed to them than the government had predicted, but the private pensions industry is now required to review some 1.5 million cases of suspected misselling where the customer lost from leaving their existing occupational or state scheme: most major insurance and pensions companies have put aside millions of pounds against the possibility of compensation. There has not however been any public or parliamentary debate on whether the various tax reliefs for pensions should be modified in any way. Consideration of them was excluded from the major enquiry set up into occupational pensions after the Maxwell affair (Goode, 1993, chapter 4.18).

This raises particularly sharply the issue of who really benefits from tax benefits. Worker and employer both contribute to most occupational pension schemes outside the civil service in the United Kingdom. Many workers never receive the full value of their contributions because they leave the firm before they retire. Until recently they often got very little back from frozen pensions and effectively they lost the value of their contributions. Necessarily, this would include the tax-subsidised part of them. Who then received this - the employer, the pension fund, or the workers who stayed on till retirement and so received the fullest pensions they could? Or are the real beneficiaries of pension tax relief the powerful pension fund industry and its constituents that pensions reformers recognise as very formidable opponents of any change in the current pension structure which would weaken their position?

However, there is no evidence that there is regular, systematic and detailed scrutiny of the incidence

of the totality of these benefits and the extent to which they represent value for money in the way that is required of benefits and services provided through public expenditure. While departments of social security regularly analyses the proportion of its public spending which goes to older people and other groups, this is not done in the Department of Finance, the Treasury or the taxation authorities.

One obvious question for such a broader review would be the distributional effect of all these tax benefits. The two governments do not publish any material: however, an OECD study has produced data on the different effective tax rates on saving through occupational pensions for the average production worker and for someone paying tax at the top rate. In contrast to the rates on other forms of saving there was much greater variation with negative effective tax rates on occasion (OECD, 1994, Tables 5.2 - 5.7). It is not suprising that those who have the resources take full advantages of these particularly favourable opportunities to provide for their retirement. With their substantial tax subsidies occupational pension schemes in both countries 'function as concealed multipliers of occupational success' as Titmuss noted (1958, p. 52).

The significance of these figures in the United Kingdom are all the greater because of the clear evidence on the growing poverty and widening inequalities in old age (e.g. Phillipson, 1993). The main distinction is between those with income from a generous and tax-assisted pension scheme or private investments and those without. In 1991 about 37% of those over the age of sixty received such a pension, 60% of men but only 23% of women. The proportion will increase since nearly half the workforce was contributing to a pension in 1991. Another fifth were probably contributing to a personal pension, and there were others who had contributed in the past to one or other arrangement but were no longer doing so (Government Actuary, 1991, Table 3.3). However, the amount of the pension varies considerably, and there are many contributors, especially women, who have not been able to build up anything approaching a full pension. Those who are dependent on National Insurance have seen the value of both the basic and the earnings-related pension substantially reduced in recent years.

In 1955 Richard Titmuss drew attention to the significance of the growth of occupational pensions supported by tax reliefs: 'the outlines of a dangerous social schism are clear, and they are enlarging. ... Already it is possible to see two nations in old age; greater inequalities in living standards after work than in work; two contrasting social services for distinct groups based on different principles, and operating in isolation of each other as separate, autonomous, social instruments of change' (in 1958, pp. 73-74). In the 1990s the picture is very much clearer: those with good private pensions of any type are better protected against poverty in old age than those who only have the state pensions or means-tested benefits. The upside-down tax benefits contribute to the growing inequality in retirement.

Conclusion

'In this world nothing can be said to be certain, except death and taxes' wrote Benjamin Franklin to a French friend in 1789, the year of the French Revolution. On this the Danish humorist Storm P. has commented: 'The only problem is that they always occur in the wrong order'. After our study we are tempted to add 'but only if you don't practise "safe tax"' - the term coined by an Irish life-insurance company as part of their marketing to promote the sale of their tax privileged insurance policies before the end of the fiscal year.

We began our report by referring to the growing number of concerns, national and international, about the escalating costs of the welfare state. The state's role, many are arguing, should be confined to providing a safety net because of the burden on taxpayers. We have tried to show that this is a partial way of looking at the problems of meeting needs in our societies. It is necessary at the same time to take account of the cost to the taxpayer of financing tax benefits, the ways they are financed and the impact they have in deciding how the resources of a society may be most effectively distributed to promote welfare. This is all the more important given that many state-assisted tax benefits distribute resources upwards, more than forwards over the lifetime or downwards in the income distribution, and in consequence lead to wider inequalities rather than to reduced poverty.

The vigorous critique of welfare state schemes in, for example, *The Pension Time Bomb in Europe*, is rarely accompanied by any close evaluation of private schemes. The Federal Trust report frequently stresses the need for less government intervention in private pensions, but their tax benefits are only mentioned in the final pages because 'the tax obstacles to greater portability' have to be tackled. It then becomes clear that their whole approach requires that 'contributions would be tax deductible against earnings wherever they originate. Capital gains and interest or dividend income earned in the EU would be free of all EU taxes' with the benefits paid being taxable (Federal Trust, 1995, p. 31). There is no consideration of the revenue costs of these and the government or general taxpayer costs are taken for granted. We could provide many other examples of this blinkered approach which does not recognise that the case for tax expenditures has to be made, just as for any other reallocation of funds, but we chose this one because it addresses an international audience and has received much favourable attention not only in the financial press but also elsewhere.

However, it is clear from our review of practice that there is now greater awareness of the significance of spending through the tax system within government in the two countries we have studied. Recent policy changes in both Denmark and the United Kingdom indicate an engagement with tax spending in many areas and there are signs of more to come. In consequence, although the amount of data and discussion of tax benefits is still extremely limited, and especially so in comparison with public spending programmes, it is a particularly interesting time to study these developments and attempt to monitor what is happening.

The concept of a tax expenditure has received increasing, though irregular, attention in both countries since its first identification some forty years ago. Over the last 15 years there have been more studies and reports. In Denmark these have tended to be one-off exercises related to certain specific issues while the United Kingdom has introduced procedures for the identification, estimation and now regular publication of tax expenditures. Both countries have acted to reduce expenditures. In Denmark this has probably been carried out more thoroughly and systematically than in the United Kingdom where there are more data publicly available. Nevertheless, it is clear that tax expenditures do not receive the same attention inside and outside government as other forms of expenditure controlled, directed or encouraged by government.

Tax benefits are not included with the totals of public spending, and in consequence are not subject to all the controls and scrutiny to which public spending is regularly subjected. Some major tax benefits are still open-ended commitments by government in both countries, and their level of

spending is not regularly and publicly monitored. In fact, the cost of some benefits, including major ones, is not at all clear. In consequence, there is very much less likelihood that they will be cut or constrained even when public spending is being placed under increasingly tight control. 'Every tax expenditure automatically has a higher budget priority than any direct spending program' (Surrey & McDaniel, 1985, p. 32).

Given the scale of the figures involved in tax benefits, it is surprising that more effort has not been devoted to resolving the debates about measurement and the possibility of aggregation. If present methods of measurement in fact make it impossible, it would seem that there is an urgent need to develop measures that would enable some form of aggregation, even within estimated bands rather than more precisely.

The provision by national governments of an annual tax expenditure budget which could be considered at the same time as public taxing and spending decisions would seem to be a basic requirement (Willis & Harwick, 1978, chapter 8). This would enable regular projections of tax spending in a form comparable to forecasts of public spending, with annual revisions of these. Functional analyses would also allow routine and systematic comparison of tax and public spending in certain policy areas (e.g., health and housing) and on particular groups (e.g., the retired and families).

Failure to take account of the cost of tax expenditures in balancing the government's budget leads to an imbalance in policy concern with the costs of public spending to the relative neglect of tax spending. In that way tax benefits and their beneficiaries - both individuals and institutions - usually become privileged, and protected, for example, from the impact of the restraints on public spending to reduce budget deficits. There are also economic implications in routing funds towards certain financial institutions and towards encouraging certain activities rather than others, e.g., home-ownership rather than industrial investment.

Our study shows the importance of moving beyond comparison of simple aggregates to analysing how different tax programmes work. Tax expenditures and public expenditures are not automatically interchangeable: they may operate in different ways with different effects and costs (Owens, 1983). Tax benefits are believed to be cheap to operate with little administrative cost and go direct to the taxpayer (Messere, 1993, p. 129). The administrative-cost advantage would presumably be reduced somewhat if they were monitored more systematically, let alone as closely as public programmes, but they could still be cheaper to run and their take-up is generally believed to be high.

The extent to which value for money is achieved by government policies directed through tax benefits is not open to parliamentary scrutiny and public debate, and it does not appear that all the benefits are regularly examined within government for this purpose. As a result two standards are allowed to operate for programmes operated through public spending and through the tax system. For example, very little research is carried out, and none as far as we have been able to establish with the recipients of these benefits, to discover how satisfactory they find them and how far they achieve their purpose.

In addition, they may fail to complement, and even operate in conflict, with explicit government policies. Sometimes they are simply inconsistent: tax benefits have tended to meet needs in different ways to public benefits - usually more generously and with less investigation than public spending programmes. Their almost parallel existence in

certain areas such as retirement requires detailed scrutiny and evaluation.

The distribution of these benefits often runs counter to frequently-expressed government policy to ensure efficient targeting towards those with the greatest need. Tax benefits are not always universal ones. Even when they are, their value is often greater for those with higher incomes and so subject to higher rates of tax: the benefit is therefore targeted upwards. This 'reverse targeting' leads to 'upside-down benefits' which are particularly beneficial to those with the highest tax liabilities.

The political implications of using the tax system rather than the public services to carry out public policies can be significant. The extent of democratic debate which is possible in relation to tax benefits is extremely limited in both countries. The benefits are generally not based on any publicly-debated objectives and there are no agreed criteria for their evaluation. Ministers responsible for them are not fully accountable within the open government traditions of either country.

Tax benefits can have the effect of subverting the progressive ideal of taxing according to 'ability to pay' into legitimating a regressive 'ability to benefit'. This is likely to weaken public support for personal taxation. There is also the further issue of who really benefits from tax reliefs given to individuals - the direct recipients or those whose services are bought with the assistance and encouragement of the tax benefits, such as the pensions and life assurance industries.

In both countries the scale and distribution of tax benefits in relation to retirement deserve particular attention. Given the upside-down nature of many of the benefits, further work on estimating their costs and their precise distributional effect seems particularly important. And given the scale of many tax benefits, the imperative to collect and provide data on their distributional impact seems all the more powerful. This argument seems to apply both as a matter of basic 'fiscal justice' (Ascoli, 1987, p. 135) and as an issue of getting value for money from public policies.

We recognise that in this report we have only been able to touch on some important issues and neglected many others. This only underlines the need for further discussion and research to develop a fuller understanding of the different tax routes to welfare and their implications for both the individual and the wider society.

We are grateful for the comments of many readers and for the assistance of Dorothy Sinfield.

Danish terms translated into English

Arbejdsløshedsdagpenge (Unemployment benefit)
Arbejdsmarkedspension (Occupational pension)
ATP (Compulsory supplementary pension)
Barselsdagpenge (Maternity benefit)
Børnefamilieydelsen (Child family allowance)
Børnetilskuddet (Child allowance)
Efterløn (Voluntary early retirement)
Engangsydelse (Lump sum)
Folkepension (National old age pension)
Fradragsberettiget (tax-deductible)
Førtidspension (Disability pension)
Kontanthjælp (Social assistance)
Sygedagpenge (Sickness benefit)
Livsforsikring (Life assurance)
Nedsat lejeværdi af egen bolig (reduced imputed value of own housing)
Personlige tillæg til folke- og førtidspension (Personal supplements to National old age pension and Disability pension)
Skattefri (tax-free or tax exempt)
Skattefradrag (tax allowance)
Underholdsbidrag (Alimony)

UK terms translated into Danish

Attendance allowance (omsorgstilskud ved invaliditet)
Age-related allowance (aldersbetinget personfradrag)
Child Benefit (børnefamilieydelse)
Child tax allowance (skattefradrag for barn)
Family Credit (supplerende indkomststøtte til familier m. arbejde)
Incapacity benefit (førtidspension)
Income Support (kontanthjælp)
Job Seekers Allowance (ny ordning m. arbejdsløshedsdagpenge)
Life assurance (livsforsikring)
Lump sum (engangsydelse)
Maternity Allowance (offentligt administrerede barselsdagpenge)
National Insurance pension (national alderspension)
One-parent benefit (børnetilskud (til enlige forsørgere))
Occupational pensions (arbejdsmarkedspensioner)
Personal Pension Plans (individuelle pensionsordninger)
Private health insurance (privat sygeforsikring)
Sickness Benefit (offentligt administrerede sygedagpenge)
State-Earnings-Related-Pension-Supplement, SERPS (obligatorisk tillægspension)
Statutory Maternity Pay (arbejdsgiveradministrerede barselsdagpenge)
Statutory Sickness Pay (arbejdsgiveradministrerede sygedagpenge)
Tax deductible (fradragsberettigede)
Tax-free (skattefri)
Tax allowance (skattefradrag)
Unemployment Benefit (arbejdsløshedsdagpenge)

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DANSK REFERAT (DANISH SUMMARY)

Denne rapport handler om den velfærd, der opnås gennem skattesystemet i Danmark og Storbritannien. Normalt ser man skattesystemet som en opkræver af midler til offentlige udgiftsprogrammer, herunder ikke mindst de offentlige velfærdsordninger. Derfor kan titlen på dette paper 'Sammenligninger af skatteruter til velfærd i Danmark og Storbritannien' umiddelbart lyde kryptisk. Det har imidlertid i nogen tid været erkendt af fx internationale organisationer som OECD og NOSOSKO, at det offentlige afholder en række udgifter i selve skattesystemet (skatteudgifter), som gavner visse befolkningsgrupper og aktiviteter gennem en særligt favorabel skattebehandling (skatteydelser).

OECD beskriver skatteudgifter som 'de omkostninger, der skyldes særlige foranstaltninger i skattesystemet, som har til formål at opnå nogle identificerbare sociale og økonomiske mål. Sådanne programmer tager generelt form af særlige undtagelser for skat, skattefradrag, skattekreditter og favorable skattesatser i skattesystemet' (OECD, 1994, p. 144). Skattesystemet får derved en dobbelt rolle, nemlig dels at indkræve skatter til at finansiere offentlige udgifter, dels gennem særlige foranstaltninger i skattesystemet at afholde egentlige offentlige udgifter.

En persons disponible indkomst eller velfærd afhænger såvel af, hvor meget den enkelte har i indkomst fra evt. arbejde og sociale ydelser, som af den skattemæssige behandling heraf. Det offentliges økonomiske støtte til en person kan således ydes direkte gennem direkte offentlige tilskud, men også indirekte gennem skattesystemet. Der behøver ikke være nogen økonomisk forskel for den enkelte modtager og for samfundsøkonomien på, om en ydelse gives gennem skattesystemet eller direkte, men der er imidlertid forskel på, hvordan skatteydelser og offentlige direkte ydelser figurerer i den offentlige statistik og den politiske debat samt ofte - men ikke nødvendigvis - på deres socialpolitiske konsekvenser.

I begge lande har man igennem længere tid været opmærksom på, at den *statslige velfærd* blot er en af tre principielle ruter til velfærd, nemlig den der dækker over de direkte offentlige ydelser (overførsler og serviceydelser). Den anden rute er den *arbejdsrelaterede velfærd*, der er de ydelser, som ofte er forbundet med at være tilknyttet en arbejdsplads eller arbejdsmarkedet.Arbejdsmarkedspensioner er det mest indlysende eksempel på den arbejdsrelaterede velfærd i Danmark og Storbritannien. For det tredje er der den fiskale velfærd eller *skattevelfærden*, som er de indirekte eller skjulte tilskud i skattesystemet. Titmuss (1958) var ophavsmanden til denne *sociale opdeling af velfærd*. Denne rapport søger at sætte fokus - igen - på skattevelfærden, der i Danmark blev beskrevet af Dich (1964) som det offentliges skjulte subsidier til persongrupper i befolkningen.

Skattevelfærden fungerer i tæt sammenhæng med den statslige velfærd og med den arbejdsrelaterede velfærd. Et eksempel på det første er skattefrie offentlige overførsler, fx børnefamilieydelsen i Danmark. Skattevelfærdens interaktion med den arbejdsrelaterede velfærd er fx fradrag for indbetalinger til arbejdsmarkedspensioner i begge lande.

Fordelingsmæssigt tenderer skatteydelser til at gå til dem, der har. Altså et omvendt Robin Hood-princip. Denne omvendte målretning af ydelser står i modsætning til de fleste socialpolitiske ydelser, der er målrettet mod personer udsat for en social begivenhed og/eller i økonomisk nød.

Skattevelfærden kaldes også den usynlige velfærd eller den usynlige velfærdsstat. Politisk bliver skatteydelserne nemlig ikke diskuteret i samme omfang som direkte offentlige ydelser, fx arbejdsløshedsdagpenge og folkepensionen. Ligeledes bliver udgifterne til skattevelfærden og fordelingen af

skatteydelser ikke beregnet og offentliggjort i samme omfang som for de offentlige ydelser. I Storbritannien er der dog årlige skøn over de enkelte skatteudgifter, mens dette ikke er tilfældet i Danmark, hvor undersøgelser er mere *ad hoc*. Ingen af de to lande publicerer informationer om fordelingen af skatteydelser fordelt på køn, alder, indkomstgrupper eller lignende.

I begge landene bliver skatteruten til velfærd stadig benyttet i udstrakt grad. Dog har man i Danmark inden for de seneste 10 år haft to skattereformer, der sammen med en række mindre ændringer har betydet et ændret udgiftsmønster. Bruttoficeringen af de sociale pensioner og af kontanthjælpen har reduceret den skattevelfærd, som er knyttet til den statslige velfærd. Storbritannien har ikke haft nogen deciderede skattereformer i den samme periode, men har generelt nedsat de marginale skattesatser. Derudover er renter på lån ikke længere fradragsberettiget på nær for huslån, hvor der dog også er sat en øvre grænse. Derimod er skattesystemet i Storbritannien blevet benyttet bevidst til at fremme private pensioner, hvilket har øget skatteudgifterne knyttet til den arbejdsrelaterede velfærd.

De private pensioner er i begge lande det væsentligste område for den skattemæssige velfærd. I Danmark har de nye arbejdsmarkedspensioner betydet større skatteudgifter, men samtidig også en større dækning af den arbejdende del af befolkningen. I Storbritannien er de private pensionsordninger også vokset i de senere år, men har i højere grad end i Danmark været forbeholdt de bedst stillede på arbejdsmarkedet.

De fleste nationale og komparative studier af overførselsindkomster omhandler de offentlige overførsler til personer i tilfælde af arbejdsløshed, sygdom, barsel, invaliditet, alderdom, tab af forsørger, børnefamilier og ved trang. Velfærdsstaten eller den statslige velfærd er genstand for undersøgelse i sådanne studier. Den skattemæssige velfærd har imidlertid en stor betydning metodemæssigt for sammenligninger af forskellige landes sociale systemer. De fleste sammenligninger af sociale udgifter til overførselsindkomster tager ikke højde for den forskellige beskatning af ydelser i landene. Der opereres med bruttobeløb i stedet for nettobeløb, som giver et mere korrekt udtryk for belastningen af de offentlige budgetter. Derudover benytter lande de forskellige ruter til velfærd i forskelligt omfang. Nogle lande benytter skatteruten langt mere end andre, ligesom den arbejdsrelaterede rute svinger i betydning. Med andre ord bliver samme problem løst på forskellig vis og kun ved inddragelse af alle tre ruter til velfærd opnås et balanceret billede af såvel den enkeltes velfærd som af belastningen på samfundsøkonomien i et land og mellem lande. (Dertil skal selvfølgelig lægges den velfærd som familien og det øvrige civilsamfund står for).

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