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## Working Party on Employment

# CHAPTER 4 - IS WORK THE BEST ANTIDOTE TO POVERTY?

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# *Chapter 4*

## IS WORK THE BEST ANTIDOTE TO POVERTY?

### Introduction

1. At the outset of the current economic downturn, a significant proportion of the working-age population consisted of individuals whose household income was below the poverty threshold. And most of them were living in a household where at least one person had a job, the so-called "working poor". In the current economic downturn, many more individuals of working-age are likely to fall into poverty either because they will lose their job or work fewer hours.

2. Traditionally, when assessing labour market performance, the main focus has been on unemployment or employment rates. But the public debate has recently put an increasing emphasis on in-work poverty. For governments, the problems faced by the working poor and jobless people are two pieces of the same puzzle: how to secure for them a route towards economic self-sufficiency? In such a perspective, the policy goal should be the same in both cases: creating more and better jobs. However, this is a particularly demanding objective since past experience suggests that more jobs do not necessarily mean better jobs. At the same time, governments also need to put in place a solid safety-net for those individuals with weak employment prospects and who may not succeed in finding a job that offers career prospects. With the ongoing steep economic downturn, these issues are becoming crucial.

3. This Chapter first presents a brief overview of the poverty situation in the OECD countries (Section 1). In particular, it explores the link between labour market outcomes and poverty incidence among the working-age population, and then focuses on the working poor. These analyses are based on a relative concept of poverty: individuals whose household income does not support living conditions considered adequate in their country of residence are typically labelled as being in poverty, even if their physical subsistence needs can be met. On the policy side, the chapter gives a picture of what OECD countries do to alleviate in-work poverty (Section 2): in particular, it focuses on the minimum wage and social transfers, among which it highlights in-work benefit schemes. In the longer run, education and vocational training should also be part of the toolbox of policies to fight in-work poverty. However, such policy options fall beyond the scope of this Chapter, which does not analyse the dynamic aspects of poverty.

### Main findings

- *The poverty rate among the working-age population varies greatly across OECD countries and is the main contributor to overall poverty headcounts.* At 10% on average in the OECD area, the poverty rate among the working-age population is sizeable. It is particularly high in Mexico, Poland, Turkey and the United States, where it exceeds 16% of the working-age population, while it remains below 7% in the four Nordic countries, Austria, the Czech Republic and France. The risk of poverty is higher than the risk of unemployment among the population aged 15-64 in most OECD countries.

- *Access to a job is a major factor limiting the poverty risk faced by households with a head of working-age.* In virtually all countries, the poverty rate among jobless households is more than double the rate observed among working households. In the present economic downturn, poverty is therefore likely to increase in the OECD area as worsening global economic conditions put upward pressure on unemployment in most member countries. This is especially the case in countries such Australia, Canada, Ireland, Korea and the United States, where more than half of individuals living in jobless households are poor (against 37% on average in the OECD area).

- *However, in-work poverty risk is significant almost everywhere.* While employment reduces considerably poverty risk, on average 7% of individuals living in households with at least one worker are poor in the OECD area. Indeed, the working poor account for more than 60% of all the poor of working-age. This proportion increases to 80% in countries such as Greece, Iceland, Japan, Luxembourg, Mexico, Portugal and Turkey.

- *For most of the working poor, underemployment is the major problem.* The average intensity of work among the working poor differs sharply from that observed among the rest of the employed population. On average over the 20 European countries for which data are available, only slightly more than 20% of the working poor work full-time full year-round and 65% of this group work 6 months or less during the year (in full-time equivalent months). By contrast, more than half of individuals living in a non-poor household work full-time over the full year.

- *Given their poor targeting, statutory minimum wages are not a very effective policy tool to fight in-work poverty.* While full-time employment at the minimum wage is typically sufficient to preclude income poverty, this is not the case for lone parents in many OECD countries and more generally, minimum wages do not offer much support to the large majority of the working poor who cannot find a full-time job. Furthermore, high minimum wages may have perverse employment effects, especially for some low-productivity workers. In this context, a number of OECD countries have reduced payroll taxes at the bottom-end of the wage ladder. But as the working poor represent only a small proportion of low-paid workers, this is a costly and potentially ineffective policy option to fight in-work poverty.

- *Net social transfers play a key role in reducing poverty among the working-age population.* On average, the rate of in-work poverty declines from 12% to 7% after net social transfers are taken into account (a 44% reduction). They also reduce substantially the poverty rate among jobless people from 84% to 38% (a 55% reduction). And overall, net social transfers cut the poverty rate almost by half among the working-age population. However, there are large differences across countries in the anti-poverty role of net social transfers. Consequently, the design of national transfer systems appears to be a key determinant of the OECD country ranking with respect to poverty rates.

- *In many countries, transfer systems do not discourage individuals with low earning potential from working.* Financial incentives to remain at work for low-wage earners living in households with disposable incomes around the poverty threshold (set at 50% of the median income) are relatively modest but still non-negligible. For these households, low-paid employment reduces substantially the severity of poverty: depending on household composition, the income gain from working varies, on average in the OECD area, from 11% to 15% of the median income compared with what people on social assistance can get.

- *However, when taking up a full-time job, low-wage workers see a large proportion of their gross earnings consumed by social contributions, income taxes and reduced social benefits.* For one-earner families, the so-called *average effective tax rate* varies on average from 70% to 80% of

gross earnings (depending on household composition), benefits withdrawal being the key component of these high rates. And for couples with children, half of additional earnings are on average taxed away when the spouse takes up a full-time job. Here, the tax burden on labour incomes plays a dominant role, and for these families, a more progressive tax system would help to make full-time employment a more solid path towards economic self-sufficiency.

- *Full-time employment may not fully secure economic self-sufficiency for families with low earnings potentials, notably when there are children in the household.* On average, working full-time at the bottom of the wage ladder (*i.e.* at around 40% of the average wage) brings disposable incomes of two-earner couples with children to only 65% of the median income, while the incomes of lone parents in low-paid work remain at the poverty threshold or even below in most countries.

- *In-work benefit schemes may constitute a valuable policy response to in-work poverty problems.* Provided that they are well-targeted and generous enough, in-work benefits (IWBs) are a cost-effective redistribution instrument, especially as compared with more traditional redistribution policies that may entail large "efficiency losses" when they damage work incentives. However, IWBs tend to be either ineffective or very expensive in countries with a narrow earnings distribution at the bottom of the wage ladder that prevents a proper targeting of these benefits. In this context, combining IWBs with a generous minimum wage may be very costly or ineffective.

## 1. Taking the measure of in-work poverty

4. Poverty is a complex concept. Several approaches exist for measuring its incidence, based on alternative criteria of what constitutes a situation of poverty for a given individual and whether poverty should be defined with respect to an *absolute* or *relative* benchmark. In this Chapter, individuals are considered as poor if their available income is substantially lower than that of a typical person in their country of residence (see Box 4.1). Then, the working poor population is formed by all individuals living in a poor household where at least one adult has a job (at some point during the year).[1]

5. In OECD member countries, most individuals who are poor according to this criterion are not lacking the minimum resources required to satisfy "basic needs". Thus, according to this *relative* definition, people are considered to be poor when they face a risk of social exclusion, in that their living conditions fall substantially below the typical standard of living in their country of residence. In this sense, the measures of poverty presented in this Chapter may constitute an upper-bound estimate of the poverty situation in OECD countries, especially for higher income countries. Indeed, this relative concept of poverty is probably more distant from a basic-needs concept in countries where per capita income is relatively high than it is in lower income countries. This must be borne in mind when making international comparisons of poverty.

1. Therefore, the working poor population is defined with respect to a household concept, as opposed to an individual concept that would focus on the individual net income of workers.

Box 4.1 **Alternative measures of poverty**

Different measures of poverty have been adopted by analysts, which provide different perspectives as to its size and evolution. Yet, all of these measures are largely determined by two main choices: *i)* selecting a measurable entity, or metric, from which a situation of poverty can be inferred; and *ii)* selecting a threshold that separates what is poverty from what is not. In both cases, there are several alternatives.

The metric used can be "monetary" or "non-monetary". It can also be "direct" or "indirect", describing final living conditions of people or, rather, the means required to achieve those conditions. Indexes of *material deprivation* are sometimes used as a direct metric, while household income – the most commonly used metric – is indirect. These two measures are related empirically, but the relationship between low income and deprivation is not very strong (OECD 2008a, Chapter 7; Boarini and Mira d'Ercole, 2006). Both measures have advantages and drawbacks and they should be seen as complements, not as substitutes. One drawback of the cash-income concept is that it does not account for the provision of in-kind benefits such as public health care, housing, childcare or education. Thus, it tends to overstate economic hardship in countries where such benefits are relatively generous, and *vice versa*. For instance, in the absence of low-priced public childcare, the economic hardship faced by low-income households with young children will be underestimated (if private childcare expenses are not subsidised by specific public cash transfers). Income-based measures of poverty thus fail to capture the effect of any anti-poverty policies providing non-market benefits to low-income families (Blank, 2008a). By contrast, the concept of material deprivation does not suffer from this kind of limitation, in principle, since it is intended to directly measure hardship. However, this category of measures crucially depends on the set of deprivation items retained in the summary index of deprivation. In this respect, it is not clear-cut which types of deprivation are best suited to capture family economic hardship and how the various items selected should be weighed to deliver the most accurate measure of poverty. The limited comparability of deprivation indexes across countries is also an important concern, since the individual measures of deprivation which are available often differ from one country to another.

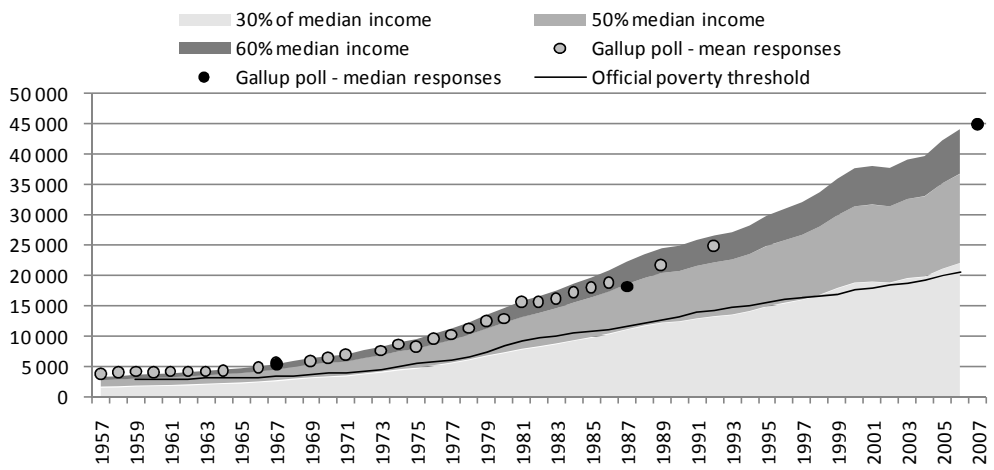
Whatever the metric used, comparisons across countries and over time are also greatly affected by whether the dividing line between the poor and the rest of the population is defined with respect to a *relative* or to an *absolute* standard of living. In this respect, national experiences differ widely across OECD countries. The United States use an absolute measure of poverty: a family is classified as being in poverty if its money income (before taxes, EITC payments and in-kind benefits) falls below a subsistence food budget – the so-called official poverty line – that has been adjusted only for price inflation since the early 1960s. By contrast, most European countries rely on a relative approach: a household is labelled as being "at risk of poverty" if its disposable income falls below a threshold set at 60% of median income. Ireland and the United Kingdom (as regards child poverty issues) have recently adopted more comprehensive approaches that use together absolute and relative measures of poverty and also combine the income adequacy concept with material deprivation indexes.

The rationale for a relative measure is that, in developed nations, poverty is fundamentally about having the resources to fully participate in society (Blank and Greenberg, 2008). This is best measured in relation to the economic capacity of middle-income families. In this context, one strength of a relative measure is that it automatically adjusts for improvements in living standards, at least to the extent that median income is a rough measure of living standards. A common objection to a relative measure is that it primarily relates information about inequality, not about basic economic need. Indeed, the incidence of poverty (*i.e.* the proportion of households whose disposable income is below a percentage of median income) will not decrease until income inequality narrows in the bottom half of the income distribution. On the other hand, a growing body of research suggests that for wealthy nations, inequality and relative position matter for well-being even for people who have sufficient income to meet "basic needs" (Summers, 2008). Furthermore, public opinion research underlines that the so-called subjective poverty threshold, *i.e.* the public opinion on the necessary minimum "get-along" income, is more consistent over time with a relative standard of poverty than it is with an absolute standard. Indeed, the latter tends to fall well below the subjective line as average income per capita increases over time (Fremstad, 2008).

Box 4.1 **Alternative measures of poverty (cont.)**

In the United States, according to the so-called Gallup polls, most people stated in 2007 that the minimum income needed to "get along" where they live was more than twice the current absolute poverty line, while this subjective poverty line was almost identical to the official threshold in the early 1960s (see Figure below). By contrast, median or average responses to the get-along question have been equal to 50-60% of median income over the whole period. But as noted by Blank (2008b), there are widely varying views about this: some will argue that this demonstrates the weakness of an absolute poverty line, while others will argue that this reflects progress achieved over time relative to a fixed income threshold. These two arguments make sense, merely reflecting the fact that the term poverty has no universally accepted meaning. Besides, when comparing the absolute poverty line with the relative threshold set at 30% of median income, changes over time have been quite similar. Therefore, given the current definition of the official poverty line in the United States, relative and absolute standards of poverty may become almost equivalent in practice, provided that the relative threshold is set at a sufficiently low percentage of median income.

**Alternative poverty measures in the United States for a family of four**, current dollars




Note: Gallup polls ask about the minimum amount of money a family of four would need to "get along in your local community."

Source: Figure adapted from Blank (2008b), Figure 4. Gallup polls data are taken from Vaughan (1993) – as reported in Citro and Michael (1995), Table 2.4 – and Jones (2007). Median income and official poverty threshold are taken from the U.S. Census Bureau.

The main lesson that can be drawn from the above example is that any poverty measure must be clear about what it seeks to measure: different concepts lead to very different poverty thresholds and, therefore, to different outcomes as regards the incidence of poverty and its evolution. At a practical level, relative income-based measures of poverty have two major advantages for international comparison of poverty: i) the distribution of household cash incomes is available in all OECD countries, and ii) while international comparisons of economic hardship based on cash income can be biased because the cash income concept does not account for international differences in the provision of non-market benefits, relative measures of poverty allow to overcome, to some extent, these kinds of difficulties. For these reasons, the present Chapter is based on such a relative income-based measure of poverty, as are most internationally comparative studies on poverty in developed countries. More precisely, individuals whose household disposable income falls below half the median value of disposable incomes in their country (see Annex Table 4.A1) are classified as being in poverty. Annual household money income, after direct taxes and public cash transfers, is adjusted for family size on the basis of the so-called "square root equivalence scale", which divides household income by the square root of household size (this implies that, for instance, a household of four persons needs twice as much income as a person living alone). The resulting "equivalent" income measure is an estimate of potential consumption for each individual in a household and individuals are defined as being in poverty if their equivalent disposable income falls below 50% of the median of the distribution of equivalent disposable income in a country. It is noteworthy that several equivalence scales exist and when measuring the incidence of poverty, the choice of one particular scale may also affect the outcome (see http://www.oecd.org/dataoecd/61/52/35411111.pdf).

### *1.1 Poverty among the working-age population: good labour market performance helps to reduce poverty risk, but does not solve all problems*

*The risk of poverty among the working-age population varies greatly across countries and is the main contributor to overall poverty headcounts everywhere.*

6. Poverty has increased over the past decade in a number of OECD countries and, on average in the mid-2000s, slightly more than one person in 10 lived in a household with disposable income below 50% of the median income in the OECD area (Figure 4.1, Panel A). However, differences in poverty rates across countries are large: while the rate of poverty among the whole population does not exceed 7% in the four Nordic countries, Austria, the Czech Republic, France, Hungary and Iceland (with a minimum of 5.3% in Denmark), it goes up to 14% or more in countries such as Ireland, Japan, Korea, Mexico, Poland, Spain, Turkey and the United States, reaching a maximum of 18% in Mexico.

7. In all countries, the poverty rate among the working-age population is the main driver of overall poverty headcounts. Individuals living in households with a head of working-age face a double-digit poverty rate in half of the 30 countries. And to give an order of magnitude, the poverty risk is higher than the unemployment risk among the population aged 15-64 in most OECD countries (Figure 4.1, Panel B). In fact, the poverty rate among the working-age population was below the unemployment rate in the mid-2000s in only 7 countries: Poland and the Slovak Republic where unemployment is particularly high; and the Czech Republic, Denmark, Finland, France and Sweden where poverty rates are relatively low. By contrast, the poverty rate was at least twice the unemployment rate in Canada, Ireland, Japan, Mexico, New Zealand and the United States, due to various combinations of high poverty rates by OECD standards and below-average unemployment rates.

8. In a number of countries where the poverty risk for the whole population is relatively high (namely, Australia, Greece, Portugal, Spain, Korea, Ireland and Japan), individuals living in households with a head of retirement-age face a poverty rate that exceeds 20%, making a significant contribution to the aggregate poverty rate. Conversely, the poverty rate among the retirement-age population is also relatively low in virtually all countries where the overall poverty rate is below the OECD average. The cross-country coefficient of correlation between the two rates equals 0.40, indicative of a common country effect across all age groups. While statistically significant, this coefficient is relatively weak. Furthermore, there is much more cross-country variability in poverty rates for the retirement-age population than for the working-age population. Poverty incidence also evolved differently over the past decade for these two age groups (Figure 4.1, Panel C). The poverty rate among the working-age population increased between the mid-1900s and the mid-2000s in a majority of countries, leading to an increase in the overall poverty rate in most cases. By contrast, the poverty rate among the retirement-age population has declined over the same period in many countries. Yet, this evolution has often been less favourable, or even unfavourable, in countries where the poverty rate among the working-age population has increased most strongly.

Figure 4.1 **Poverty in OECD countries**

*Employment status is a major determinant of the poverty risk faced by households with a head of working-age.*

9. When averaged over the 30 OECD countries, poverty rates among the working-age population vary substantially across household types (Figure 4.2, Panel A). In particular, households with children always fare worse than their childless counterparts with a comparable employment status. It is also striking that jobless households face substantially higher poverty rates than households with identical family structure but with at least one worker. Despite these differences, a significant risk of poverty exists in

virtually all cases. Two-earner couples without children are in the most favourable situation, with an average poverty rate over the 30 countries of just 2.4%. But the risk of poverty increases significantly with the presence of children and especially in jobless households where on average it could reach almost 50%.

10. It is noteworthy, however, that poverty rates differ considerably across OECD countries for each type of household. In most cases, the difference between the highest and the lowest poverty rate over the 30 countries is at least twice the average rate. That said, the presence of children tends to increase poverty risk in virtually all countries, a pattern that is of particular concern since a number of studies have shown that poverty undermines child development. Regardless of the number of adults in the household and their the employment situation, on average 10.5% of individuals living in households with children are in poverty in the OECD area, 2 percentage points above the rate for childless households (Figure 4.2, Panel B). This difference goes up to more than 10 percentage points in Mexico, Poland and the United States, where households with children face a poverty rate more than 5 percentage points higher than the OECD average. By contrast, in countries with low overall poverty rates (as well as Korea), poverty is less a problem among families with children than among childless households. For instance, in the four Nordic countries, the poverty rate among families with children never exceeds 4% and may be less than one-half the poverty rate observed among their childless counterparts.

11. Differences in poverty rates are even larger when comparing jobless and working households (regardless of the presence of children). On average in the OECD area, 37% of individuals living in jobless households are poor, a proportion that is 5 times higher than that for households with at least one worker (Figure 4.2, Panel C). In virtually all countries, the poverty risk among jobless households is more than double the rate observed among working households and almost never falls below 20%. More than half of individuals living in jobless households are poor in 5 of the 30 member countries (Australia, Canada, Ireland, Korea and the United States). The ongoing economic downturn may thus have a particularly large impact on poverty in these countries, should unemployment increase as much as is now projected (see Chapter 1).

Figure 4.2 **Poverty rates among the working-age population for various types of household[a]**

*But at the aggregate level, employment performances are not the main driver of cross-country differences in the overall poverty risk among the working-age population.*

12. Since jobless people face a much higher poverty risk than the rest of the population in all countries, cross-country differences in aggregate poverty rates among the working-age population may reflect differences in labour market performances, along with differences in the extent to which countries have successfully implemented comprehensive strategies to fight poverty.[2] This section decomposes cross-country differences in overall poverty rates for the working-age population into these two types of national differences.

2 . For instance, a country in which the poverty rate for each household type is close to the OECD average, but where there are relatively few jobless households, will have a relatively low aggregate poverty rate among the working-age population. This relatively low risk of poverty among the whole population would, however, reflect strong labour market performance, rather than effective anti-poverty policies, such as a well-designed system of social transfers. Similarly, a country with an average labour market performance, but particularly effective anti-poverty policies, might also achieve a below-average aggregate poverty rate among working-age households. In this case, however, poverty rates for different types of households would tend to be below the OECD average, whereas the mix of household types might be close to the OECD average.

13. For the sake of simplicity and clarity, the decomposition presented in Figure 4.3 splits the working-age population into just two broad categories: *i)* households containing at least one worker, and *ii)* jobless households.[3] Labour market performance does not appear to be the main factor underlying cross-country differences in overall poverty. By contrast, the incidence of poverty *within* groups –working and jobless households– plays a predominant role. In all countries where the overall risk of poverty among the working-age population is relatively low (high) by OECD standards, the aggregate poverty rate would be higher (lower) if poverty rates for both working and jobless households were, instead, the same as those observed on average in the OECD area (Figure 4.3, Panel A). In fact, equalizing poverty rates for these two groups to the OECD average would reduce dramatically the cross-country variance in aggregate poverty rates (the standard deviation would decrease from 4.7 to 1.4). By contrast, differences in the country composition of households by the employment status play only a modest role in explaining the cross-country differences in overall poverty. Aggregate poverty rates among the working-age population would not change as much (nor as systematically) if all countries had the same population structure as holds on average in the OECD area (the standard deviation of aggregate poverty rates would increase slightly from 4.1 to 4.4).

Figure 4.3 **Cross-country differences in poverty rates among households of working-age**

14. Changes over the past decade broadly follow the same pattern: they have been driven mostly by changes in poverty rates at the household level, rather than by changes in population structure (Figure 4.3, Panel B). Changes in the share of working households among the population of working-age had a relatively strong impact on poverty in only 4 of the 21 countries for which data are available: Australia, Belgium and Spain, where rising employment rates helped contain the rise or even led to a reduction of the poverty rate among the working-age population, and in the Czech Republic, where falling employment rates had the opposite effect.

15. Obviously, these simple decompositions do not imply that successful employment policies cannot be a powerful tool to fight poverty. Rather, they demonstrate that other important factors also determine poverty risk for working-age households. Interestingly, the same pattern emerges when looking at the correlation between poverty rates among the working-age population and employment rates (Table 4.1). Poverty rates tend to be lower in countries where a larger proportion of individuals of working-age have a job and these correlation coefficients are highly significant in most cases. This confirms that good labour market performance, indeed, helps to reduce poverty risk. However, these coefficients are relatively small, suggesting that policies to fight poverty cannot rely entirely upon good labour market performance. Policies to achieve high employment rates need to be complemented with a solid safety-net for households containing only workers with a low earnings potential. In this respect, as the incidence of income-poverty is measured after net social transfers, this weak relationship between employment performance and overall poverty – in international comparison – may also indicate that countries differ in the generosity of social transfers granted to those individuals with weak employment prospects and who may not succeed at finding a job or good job (see *infra*).

Table 4.1 **Correlation coefficients between poverty rates and employment rates**

3 . However, the same results hold when splitting the working-age population over the 10 types of households for which data are available, as might be expected because most of the variability in poverty rates across household types is related to employment status.

### *1.2 In-work poverty risk is significant in virtually all countries*

*The working poor constitute an important target population for anti-poverty policy in most OECD countries.*

16. While employment considerably reduces poverty risk, 7% of individuals living in households with at least one worker are poor on average in the OECD area, a proportion that has slightly increased over the past decade (Figure 4.4). As with overall poverty rates, cross-country differences of in-work poverty rates are sizeable. While in-work poverty rates are relatively low in the four Nordic countries, Australia, the Czech Republic and the United Kingdom – not exceeding 4% of the working population –, more than one in ten individuals living in households where at least one person has a job is poor in Japan, Mexico, Poland, Portugal, Turkey and the United States (Figure 4.4, Panel A). In-work poverty rates have also evolved very differently in different countries since the mid-1990s. While the rate increased in more than half of the 24 countries analysed, Italy and Mexico achieved sharp declines and the OECD average increase was less than 1 percentage point per year (Figure 4.4, Panel B).

17. The working poor constitute an important target population for anti-poverty policy in most OECD countries. Indeed, they account for more than 60% of the poor of working-age in the OECD area on average, and up to 80% in 7 of the 29 countries for which data are available: Greece, Iceland, Japan, Luxembourg, Mexico, Portugal and Turkey (Figure 4.4, Panel A). While these proportions tend to mirror the rate of in-work poverty in each country, they are more strongly correlated with the relative risk of in-work poverty (*i.e.* the ratio between in-work and overall poverty rates) rather than to in-work poverty rates *per se*. For instance, the share of working poor among the poor population of working-age is essentially the same in New Zealand, Denmark or Finland, but the rate of in-work poverty is twice as high in New Zealand as in the latter two countries. It may be that these shares reflect, at least in part, the particular emphasis devoted to the problem of in-work poverty in each country. Interestingly, compared with the rates of in-work poverty, these shares have been rather stable over the past decade and have even decreased in a number of countries (Figure 4.4, Panel B).

Figure 4.4 **In-work poverty in OECD countries**

18. The in-work poverty risk also varies strongly according to family composition (Figure 4.5, Panel A). Households with children tend to face much higher in-work poverty rates than their childless counterparts in virtually all countries, although this difference is much smaller for two-earner couples. The highest in-work poverty rates are observed either for lone parents (in a majority of countries) or for one-earner couples with children (notably, in Australia, Greece, Iceland, Italy, Poland, Portugal and Sweden). Denmark and Finland are notable exceptions to this general pattern. In these two countries, single persons without children face the highest in-work poverty rates among the 6 types of household shown in Figure 4.5. In one third of OECD countries, in-work poverty rates among lone parents and/or one-earner couples with children exceed 20%. By contrast, the risk of in-work poverty is much lower for two-earner couples, for whom the rate of in-work poverty remains below 5% in virtually of all countries (expect in Japan and Turkey), irrespective of the presence of children. Moreover, these rates have remained relatively stable over the past decade in a majority of countries, which again stands in sharp contrast with the rising rates of in-work poverty for lone parents and/or one-earner couples with children over the same period, that were observed in more than two thirds of the 21 countries for which data are available (Figure 4.5, Panel B).

Figure 4.5 **In-work poverty risk varies strongly according to family composition**

*Work participation on both the extensive and intensive margin is part of the story.*

19. On average, half of the working poor live in households where all adult members have a job (be they single persons or two-earner couples). This proportion varies substantially across countries and one-earner couples may account for more than 2 thirds of the working poor in countries such as Australia, the Czech Republic, Greece, Italy, Poland, Portugal, the Slovak Republic and Spain (Annex Figure 4.A1, Panel A). But differences in this form of underemployment do not appear to be the main factor underlying cross-country differences in overall in-work poverty (Annex Figure 4.A1, Panel B). Once again, cross-country differences in the group-specific rates of poverty (for one-earner couples and for households where all adults have a job) explain most of the international differences in the overall rates.

20. This notwithstanding, *work participation* may have a substantial effect on the overall rate of in-work poverty observed in each country. Who works and who does not provides an incomplete picture of the extent of underemployment and its potential impact on in-work poverty. *Work participation on the intensive margin* is reflected in the number of months worked over the year and weekly hours worked while employed. When taking into account these two dimensions of work intensity, in addition to the fact that a number of individuals – living in a poor household where at least one adult has a job – do not work at all, the average intensity of work among the working poor differs sharply from that observed among the rest of the employed population.

21. Figure 4.6 reports the average number of months spent at work per household member aged 20-64. Among all persons living in a poor household, only slightly more than 20% work full-time and 65% of this group work on average 6 months or less over the year (in full-time equivalent months). By contrast, slightly more than 50% of individuals in non-poor households work full-time, and only 27% of them work on average 6 months or less over the year (Figure 4.6, Panel A). These are average figures for the 20 European countries for which data are available and the situation differs somewhat from one country to another. Nonetheless, underemployment on both the extensive and intensive margins appears to be a major determinant of in-work poverty in all countries (Figure 4.6, Panel B). Everywhere, more than half of the working poor work on average 6 months or less over the year (in full-time equivalent months).

22. Not surprisingly, poverty rates increase sharply as the average time spent at work per household member decreases. On average over the 20 European countries, only 2% of full-time, year-round workers are poor, a proportion that rises slightly to 2.8% when the average time spent at work is less than 12 months but remains above the 6 full-time equivalent months. However, it then increases more sharply to 8% for people spending on average 6 months at work, going up to 20% when on average less than 6 months are spent in employment (Figure 4.6, Panel C). In-work poverty rates vary across countries, notably when the average employment duration over the year is short. Indeed, among people working on average less than 6 months, the rate of in-work poverty is below 15% in Belgium, Denmark, Finland, Germany, the Netherlands, Sweden and the United Kingdom, but is more than twice as high in Iceland, Italy, Hungary, Poland and Spain.

Figure 4.6 **Average time spent at work over the year and corresponding rates of in-work poverty, 2005**

23. Work participation on the intensive margin has a substantial effect on the overall rate of in-work poverty observed in each country. A simple simulation suggests that if all persons working at some point during the year, spent at least 6 months at work (in full-time equivalent months), the rate of in-work

poverty could be reduced by 17% on average over the 20 European countries (Figure 4.7, Panel A).[4] And assuming that all persons who effectively have a job work full-time full-year could reduce the rate of in-work poverty by up to 39% on average. Also taking into account work participation on the extensive margin, by assuming that all jobless persons instead work full-time year-round, would further reduce in-work poverty: increasing work participation on both the intensive and extensive margin would indeed reduce the rate of in-work poverty by 65% on average (Figure 4.7, Panel B). Overall, the effect of work participation on the intensive margin tends to be stronger than the impact of work participation on the extensive margin. The latter plays a predominant role in only 6 of the 20 European countries: Belgium, the Czech Republic, Italy, Poland, the Slovak Republic and Spain. Interestingly, in all cases, there is no clear relationship between the observed rate of in-work poverty and the potential reduction that could be achieved through increasing work participation.

Figure 4.7 **Work participation at the extensive and intensive margins and in-work poverty rates, 2005**

24. To sum up, this descriptive analysis of poverty in OECD countries delivers two main messages:

- First, *employment plays a key role in reducing the risk of poverty in each country*: *i)* among the whole population of working-age, jobless people face substantially higher poverty rates than the rest of the population; and *ii)* among the employed population, households whose head and spouse spend few months at work during the year are much more exposed to poverty than households with full-time workers.

- Second, *employment is not a panacea*, and there are other potentially important contributors to poverty headcounts in each country: *i)* in international comparison, there is no clear-cut relationship between labour market performances and poverty rates among the working-age population; and *ii)* cross-country differences in rates of in-work poverty are only partially explained by cross-country differences in work intensity of the working poor at the extensive and intensive margins.

**2. Alleviating in work-poverty**

25. To fight in-work poverty, OECD governments can directly act on low wages through setting a statutory minimum wage. Provided that employment spells over the year are long enough, such a wage floor may guarantee a minimum income to families with a low earnings potential. To some extent, out-of-work benefits also set a wage floor, since they indirectly determine the earnings level from which employment brings additional net incomes, so that there are financial incentives to work. More generally, the design of national social transfer systems, *i.e.* the generosity of out-of-work benefits, as well as the way earnings of low-income families and social transfers are combined, are key elements in the toolbox of policies to alleviate in-work poverty. In the longer run, the policy goal should be to strengthen the employability and the earnings potential of those workers experiencing recurrent spells of poverty, notably through vocational training and other education programmes (Blank, 2008a). Although potentially crucial, this kind of career development policies falls beyond the scope of this Chapter.

4. This is a rough upper-bound estimate of the potential reduction of the overall in-work poverty rate, since it is based upon the assumption that the rates of in-work poverty observed for higher intensity of work would not change even if a large number of persons would increase their intensity of work.

### *2.1 Making the most of the minimum wage*

26. Since earnings from work are the most immediate determinant of in-work incomes, minimum wages are often seen as an important policy tool to fight in-work poverty. However, the minimum wage should not be regarded in isolation, but rather considered as part of a policy strategy to raise the incomes of workers at the bottom of the wage ladder. From the perspective of an anti-poverty policy, the *net* incomes of minimum-wage earners matter more than minimum wage levels *per se*. At a first glance, given the tax and benefit systems in place, a useful benchmark for assessing the adequacy of a national minimum wage is whether full-time work at this wage level allows workers to escape poverty.

*In countries with statutory minimum wages, full-time work at the minima allows escaping poverty in most cases…*

27. In virtually all countries where a statutory minimum wage exits, it is set high enough to prevent in-work poverty for most household types in which all working-age adults are employed full-time. However, lone parents are often a notable exception. The disposable incomes of households where all adults are working full-time at the minimum wage show the following patterns:

- Net equivalised incomes of childless couples vary between 50-60% and 100% of the median income in most countries (Figure 4.8, Panel C). These levels are somewhat lower when there are children present in the household, but still adequate to preclude in-work poverty except in the case of the United States (but this has to be qualified by the fact that in these country, the official poverty line, and thus the effective target in terms of poverty reduction, is well below 50% of median income).

- While often significantly lower than for childless couples, net equivalised incomes of single persons without children remain above half the median income in a majority of countries (Figure 4.8, Panel A). Disposable incomes fall significantly below the poverty threshold in only 4 cases: in the United States, Luxembourg, Korea and Canada.

28. On the other hand, net (equivalised) incomes of couples where only one adult works full-time at the minimum wage remain below the poverty threshold in most countries (Figure 4.8, Panel B). But in these households, the earnings potential is not fully exploited (*cf.* the discussion of underemployment in Section 1). The situation of lone parents (with 2 children) appears to be most critical: in 9 out 20 countries, working full-time at the minimum wage level does not allow such households to escape poverty (Figure 4.8, Panel A). In Spain, the United States, Greece, and Portugal, net (equivalised) income does not even reach 40% of the median income. At the other extreme, lone-parents in the United Kingdom, Ireland and Australia have net incomes exceeding 65% of the median income when working full-time at the minimum wage.

Figure 4.8 **Net incomes of full-time minimum wage earners**

29. Interestingly, while net incomes of childless households tend to be closely related to national minimum wages (expressed as a percentage of the median wage), the link is much weaker – or even disappears – for families with children, whose disposable incomes also depend strongly upon social transfers. Moreover, it should be emphasised that barriers to employment – or to full-time, full-year employment – may mean that much of the anti-poverty potential of minimum wages is not realised in practice. This may be a particular risk if statutory minima are not combined with other polices intended to enhance employability and reduce barriers to working (e.g. job training programmes and access to affordable childcare).

*… but as a tool to fight in-work poverty, minimum wages are not well-targeted*

30. When assessing the potential impact of the minimum wage on poverty, its effects on employment should also be considered. Possible disemployment effects among workers whose employment status is most vulnerable may worsen, rather than improve, the income situation of a number of households. For instance, there are clear indications that a high minimum wage may deter employment prospects of disadvantaged youth (Neumark and Wascher, 2006)[5], although there is no convincing evidence of a strong disemployment effect at the aggregate level (OECD, 2006).

31. Second, and perhaps more importantly, as a tool to fight in-work poverty, minimum wages are not well-targeted. In this respect, a number of studies suggest that a large proportion of the working poor would not benefit from a minimum wage increase, because they already earn hourly wages above the minimum (*e.g.* Burkhauser and Sabia, 2008, for the United States; Sutherland, 2001, for the United Kingdom). More generally, the overlap between low-paid employment and in-work poverty is rather low. Indeed, only slightly more than half of the working-poor live in households where there is at least one person employed in a low-paid job (on an hourly basis), on average over the 18 European countries for which data are available (Figure 4.9, Panel A). This proportion varies across countries, but never exceeds two thirds of the targeted population. And in all countries except Austria and Iceland, less than one in ten of the working poor live in households with two low-wage earners. Moreover, these figures give an upper-bound estimate of the share of working poor who would benefit from a minimum-wage increase or from the introduction of such a wage floor. While a minimum wage may put upward pressure on low wages above the minimum level, this diffusion effect is unlikely to affect all low-paid workers (Neumark *et al.*, 2000).

32. A number of countries have reduced employer's social security contributions at the minimum-wage level in order to mitigate potential disemployment effects. Such policies entail large deadweight costs. Minimum-wage workers are a heterogeneous group and not all of them face the same risk of job loss as a result of a minimum-wage increase. From the specific perspective of fighting in-work poverty, potential deadweight costs are even larger, since a large majority of the beneficiaries of these fiscal measures are not poor. Indeed, the working poor represent a small share of all low-wage workers. On average over the 18 European countries for which data are available, less than one in ten low-wage workers lives in a poor household (Figure 4.9, Panel B). Put differently, deadweight costs would exceed 90% in the majority of these countries, while exceeding 80% in all of them.

Figure 4.9 **Overlap between in-work poverty and low-paid employment, 2005**

### *2.2 Social transfers: a key component of policy packages to fight poverty*

33. Social transfers can be more effective at reducing in-work poverty than high minimum wages, because they can be explicitly targeted to complement the earnings of low-paid workers in low-incomes families. And indeed, *net* public transfers, that is the combination of *gross cash public transfers* and *households taxes*, play a key role in reducing poverty among the working-age population in virtually all OECD countries.

5 . This would be most untimely in the context of the current economic downturn, as youth employment is particularly sensitive to the economic cycle (see Chapter 1 and OECD, 2008b, 2009). In addition, recent studies suggest that a hypothetical increase in the US minimum wage would reduce employment, hours worked and earnings for less-educated single mothers and, therefore, would fail to alleviate poverty (Sabia, 2007; Brandon, 2008).

*Net social transfers are a major determinant the observed cross-country differences in poverty rates*

34. The effect of net social transfers can be measured by comparing poverty rates based on disposable income (*i.e.* the income concept used so far) with the incidence of poverty that would be observed in absence of gross transfers and households taxes. More precisely, poverty rates before net social transfers refer to the share of people with market income (*i.e.* pre-transfer/tax income) below 50% of household *disposable* income (see OECD 2008a, Chapters 4 and 5). Therefore, the difference between the poverty rates based on disposable and market income reflects both the size of net social transfers and the extent to which these are targeted to the poor. This difference measures a "first-order" effect of net social transfers on poverty, since it does not take into account the possible impact of these transfers on the distribution of market income itself.

35. On average over the 27 countries for which data are available, net social transfers cut the poverty rate by almost half among the working-age population (Figure 4.10, Panel A). There are large differences across countries, however. In countries such as Denmark, France and Sweden, the poverty rate among households with a head of working-age falls by more than two-thirds after transfers, while in Canada, Japan, Korea, Spain and the United States, the reduction achieved represents less than one-third of the poverty rate before social transfers.

36. On average, social transfers reduce the poverty rate among jobless people by slightly more than half, from 84% to 38% according to countries (see also Annex Figure 4.A2). By comparison, the average reduction achieved among households where at least one person is at work, while still sizeable, is smaller. The rate of in-work poverty declines from 12% to 7% after social transfers (a 44% reduction). Similarly, in virtually all countries, transfers are more effective in alleviating poverty among one-earner couples than among households where all adults are working. On average, the rate of in-work poverty is cut by 50% among the former, against slightly less than 40% among the latter (Figure 4.10, Panel B).

37. Here again, the extent to which social transfers impact on the risk of poverty faced by these different categories of the population may vary substantially from one country to another:

- A small number of countries appear to place greater emphasis in their social transfer system on alleviating poverty for working households than for jobless households. This pattern is observed in Australia, Canada, Ireland, the United States and, to a lesser extent, the Czech Republic and Korea.

- In some other countries, including Hungary, Norway and Spain, the impact of social transfers on poverty rates is neutral towards these two groups.

- In a third group of countries, social transfers appear to be much more targeted towards jobless households than working households, reducing the poverty rate of the latter to a much lesser extent than that of the former. This pattern is observed in a relatively large group of countries, including Austria, Belgium, France, Greece, Iceland, Italy, Luxembourg, Mexico and Portugal. In Japan, transfers even slightly increase the poverty rate among working households.

Figure 4.10 **By how much do net social transfers reduce poverty?**

38. As a result of this diversity, differences in national social transfer systems substantially affect cross-country differences in poverty rates. This is especially true for people living in jobless households, but is also true to a lesser extent for working households (Figure 4.11). In fact, the design of national transfer systems appears to be a key determinant of the OECD country rankings with respect to poverty

rates. Indeed, the cross-country standard deviation of national poverty rates relative to the OECD average is always larger after social transfers than before. Furthermore, a number of countries end up above (below) the OECD average after social transfers, whereas they have the opposite position in the distribution of (relative) pre-transfer poverty rates. In most of the remaining countries, the size of the gap between national poverty rates and the OECD average rates after social transfers is mainly explained by those transfers and not by the pre-transfer position of these countries. This pattern is particularly marked when looking at the relative poverty rates of people living in jobless households, but it also comes out rather clearly for the overall (relative) rate of poverty among the working-age population, and then more weakly for (relative) in-work poverty rates. Looking at the overall rate of poverty, taking into account social transfers – when measuring the incidence of income-poverty – deters a lot the relative position of Korea, Japan, Mexico, Spain and the United States, while it has the opposite effect in countries such as Belgium, Denmark, France and Hungary.

Figure 4.11 **How much do social transfers affect cross-country differences in poverty rates?**

39. While in cross-country comparison, there was no clear relationship between actual poverty rates observed after social transfers and labour market performances, this is not the case when the incidence of poverty is measured before transfers (Figure 4.12). When decomposing poverty rates before social transfers in the same way as was done for poverty rates after transfers in Section 1, it appears that (before transfers) cross-country differences in the incidence of poverty observed among, respectively, persons in jobless and working households are not the main drivers of country ranking with respect to national poverty situations among the working-age population as a whole. Rather, this ranking mostly reflects cross-country differences in the share of households where at least one person has a job, among all households with a head of working-age. Poverty rates before transfers are indeed strongly linked to employment rates (Table 4.2), the cross-country correlation coefficient being often more than twice as high as that observed between employment rates and poverty rates after social transfers. Put differently, social transfers markedly weaken the link between employment and the poverty rate observed among the whole working-age population.

Figure 4.12 **Cross-country differences in poverty rates before social transfers and labour market performances, mid-2000s**

Table 4.2 **Correlation coefficients between employment rates and poverty rates among the working-age population, before and after social transfers**

*A closer look at the interaction between social transfers, employment and in-work poverty*

40. As noted above, social transfers play a key role in reducing poverty among jobless people, and to a lesser extent, among those who are working. In fact, the interaction between social transfers and employment is rather complex. First, generous out-of-work benefits may reduce financial rewards from working if they are not carefully designed. What matters is both the level of out-of-work benefits and the way they are withdrawn at the bottom-end of the wage ladder. Second, the role of social transfers is not limited to create or preserve incentives to work. They should also complement wage incomes of families with very low earnings potentials, so that full-time work is an effective route out poverty. Using the OECD tax and benefit models (see Box 4.2), this section reviews the key aspects of the tax and benefit position of low-income families who are making an effort to support themselves through work.

Box 4.2 **OECD tax and benefit models**

OECD tax and benefit models allow one to assess the features and consequences of tax and benefit policies in 29 OECD countries. The models take into account all those complex legal rules concerning entitlement to benefits as well as tax obligations in different countries. The OECD models thus help assessing how taxes and social benefits affect incomes of different individuals in and out of work for different family types, various intensities of work (per week and per worker) and different earnings or previous earnings levels. Calculations take into account the income taxes and social security contributions due on earnings and benefits. Benefits such as unemployment benefits, social assistance, family benefits, housing benefits and in-work benefits are included in the calculations (for further details, see www.oecd.org/els/social/workincentives). However, the models do not take account of behavioral responses to changes in tax and benefits.

All tax-benefit calculations presented in the present chapter refer to families with low earnings potentials, where head and spouse (when relevant) are paid an hourly wage equal to 40% of the average wage (or to the minimum wage if the latter is higher than 40% of the average wage). Full-time employment corresponds to 40 hours of work per week and per worker. When relevant, housing costs used to calculate housing benefits are assumed to be equal to 10% of the average wage. This is a rough approximation of housing costs, which are assumed to be much lower for low-income families than for a typical family that is assumed to pay around 20% of the average wage in housing costs in the baseline scenario of these models.

41. The number of working hours necessary for low-paid workers to reach the poverty threshold (set at 50% of the median equivalised income) gives a first picture of the relationship between employment and net social transfers, without distinguishing benefits granted to jobless people from those paid to employed persons for the moment (Figure 4.13):

- On the one hand, net social transfers does not appear to be overly generous in most countries. At first glance, it does not come out clearly that those transfers may discourage individuals with low earnings potential to take up a regular job: on the contrary, in most cases, few hours of work do not allow to escape poverty. Only 6 countries stand in sharp contrast to this general picture: Australia, Ireland, Germany, New Zealand, Poland and the United Kingdom. In these countries, a part-time (low-paid) job – with sometimes very few hours of work – allows reaching the poverty threshold in many cases.

- On the other hand, in most countries, it is possible for families with very low earnings potentials to escape poverty, provided that they work the equivalent of a full-time job of around 40 hours per week. Indeed, 40 to 45 hours worked in a low-paid job, per week and per adult in the household, are sufficient for disposable incomes to cross the poverty threshold in most cases. The situation is critical in only 5 of the 24 countries, for lone parents with 2 children. In Norway, Portugal, Spain, Switzerland and the United States, the latter indeed have to work more than 50 hours weekly for their disposable incomes to reach the poverty threshold.

Figure 4.13 **Total number of working hours necessary to reach the poverty threshold, 2005**

42. However, a more comprehensive picture of the interaction between net social transfers and employment requires distinguishing those transfers granted to jobless people from those paid to employed persons. For families with low earnings potentials, the financial payoff from work is not fully depicted by the level of disposable incomes that can be reached, although the latter remains the true determinant of the living conditions that can be achieved. Financial rewards from working also depend on the net amount of *additional* incomes brought by employment, as compared with the amount of transfers received by social assistance recipients. The latter varies significantly across countries and, at the poverty threshold, it entirely determines the financial payoff from work (since by construction, employment provides households with the same net incomes in all countries, equal to 50% of the median income). Depending on

family composition, the average net amount of out-of-work benefits paid to jobless people on social assistance varies from 35% to 40% of the median income on average in the OECD area, which is well below the poverty threshold (Figure 4.14). As a result, on average over the 24 OECD countries for which data are available, financial incentives to remain at work for low-wage earners living in households with disposable incomes around the poverty threshold are relatively modest but still non-negligible. Depending on household composition, the income gains from working vary from 11% to 15% of the median income compared with what people on social assistance would get. Therefore, employment substantially reduces the severity of poverty. These low-income households would indeed lose 22% to 30% of their disposable incomes, if they were to end up back on social assistance.

Figure 4.14 **Net additional incomes brought by low-paid employment, as compared with incomes from social assistance[a], 2005**

43. Strikingly, in all cases, countries with very different levels of out-of-work benefits may end up with a quite similar number of working hours necessary to reach the poverty threshold, reflecting the extent to which net social transfers are reduced as earnings increase in each country. Figure 4.15 reports the *average effective tax rate* when taking up low-paid employment. To facilitate cross-country comparisons, the latter refers to a full-time job in all countries. On average over the 24 OECD countries, the proportion of gross earnings offset by reduced social benefits, social contributions or income taxes varies from 70% to 80%, depending on household composition. This means that less than 20% to 30% of those modest earnings add to available net income. Because benefit withdrawal is the main driver of effective tax rates at the bottom of the wage ladder, work incentives tend to be weaker for families with children than for childless households, as out-of-work benefits are more generous for the former (so the impact on family budgets is greater when these benefit payments are lost or reduced as a result of higher employment incomes).

44. However, a small number of countries manage to combine above-average incentives to work for families with low earnings potentials, with a solid safety-net for jobless people. For instance, lone parents with 2 children face low effective tax rates in Australia, Ireland and the United Kingdom. And although the amount of social transfers granted to social-assistance recipients is relatively generous in these countries by OECD standards, the financial payoff from working full-time in a low-paid job is substantial, amounting to more than 20% of the median income (against an average of 12% over the 24 OECD countries). Financial incentives to work – as compared with benefits received on social assistance – are similar in countries such as Hungary and the United States, but this has to be weighed against the fact that in these two countries, lone parents may face severe poverty if they do not succeed in finding a job.

45. Likewise, as a result of relatively low effective tax rates, one full-time job at the bottom of the wage ladder brings significant incomes gains to couples with children in New Zealand, the United Kingdom, and to a lesser extent, in Ireland, although the total amount of social transfers that these families can get on social assistance is relatively high by OECD standards. In these countries, one full-time job allows couples with children to cross the poverty line. Strikingly, while this is not the case in most other countries, financial incentives for a spouse to take a low-paid job are relatively weak (Figure 4.15, Panels B and C). For families with children, half of the additional earnings are on average taxed away. As a result, income gains are relatively low, amounting to 10% of the median income when the spouse works half-time, and to 20% of the median income when he/she works full-time. Average effective tax rates are lower for childless couples, since the amount of benefits received by one-earner couples (working 40 hours per week) tends to be very low. In fact, net social transfers are negative in most countries, meaning that the amount of social contributions and income taxes paid exceeds the amount of benefits received. The tax burden on labour incomes is therefore the main driver of the effective tax rate, which on average still goes up to 37% of the additional earnings when the spouse takes up a full-time job (Figure 4.15, Panel C). And

for families with children, while benefits withdrawal remains the key component of high effective tax rates when the spouse works half-time (Figure 4.15, Panel B), social contributions and income taxes play a dominant role when he/she takes up a full-time job (Figure 4.15, Panel C). For these families, a more progressive tax system would help to make full-time employment a more solid path towards economic self-sufficiency.

**Figure** 4.15 **Average effective tax rates for households with low earnings potentials, 2005**

46. Although these high effective tax rates do not prevent families with low earnings potentials to cross the poverty threshold when all adults are working full-time, economic self-sufficiency may not be fully secured. In many cases, disposable incomes do not go far beyond – or even remain below – 60% of the median income, an income level at which the poverty threshold is commonly set in many European countries (Annex Figure 4.A3).

47. In this respect, two-earner couples without children fare better than families with children, and to a lesser extent, than singles without children (Annex Figure 4.A3, Panel C). On average over the 24 countries for which data are available, working full-time in low-paid employment brings disposable incomes of two-earner couples (without children) to 80% of the median income, thus significantly above the poverty threshold. For single adults without children, the situation is more contrasted (Annex Figure 4.A3, Panel A). Disposable incomes remain below 60% of the median income in a majority of countries, reaching on average only 58% of the median income. Full-time employment constitutes a more solid path towards economic self-sufficiency in Australia, Belgium, Germany, France, Ireland, Korea, New Zealand and the United Kingdom, where net incomes of full-time workers vary between 65% and 70% of the median income.

48. The picture is quite different for families with children (Annex Figure 4.A3, Panels B and D). On average, working full-time in low-paid employment brings disposable incomes of two-earner couples with children to only 65% of the median income, while available incomes of lone parents remain at the poverty threshold or even below in most countries. In fact, net incomes of lone parents exceed significantly beyond this threshold in only 3 countries, namely Australia, Ireland and the United Kingdom, ranging from 68% in the latter from 77% in Australia. Not surprisingly, these are the 3 countries highlighted in the previous section as managing to combine below-average effective tax rates for lone parents facing particular labour market challenges, with a solid safety-net for those who fail to find a job.

### *2.3 In-work benefit schemes can be an effective tool to fight in-work poverty*

49. Of course, increasing financial rewards from working at the bottom of the wage ladder could be done by reducing the level of benefits for jobless people. But this would in turn increase poverty among those who are unable to take advantage of the increased incentives to find work, and would leave the situation of the working-poor unchanged. Instead, a growing number of OECD countries have introduced in-work benefits (IWBs) or tax credits for individuals facing particular labour market challenges.

*Distributional properties of IWBs varies significantly from one schemes to another*

50. IWBs not only create additional financial rewards for seeking work, they also increase the payoff of remaining in work for recipients who already have a job. In other words, these schemes redistribute resources to low-income families who are making an effort to support themselves through work. Countries differ in the emphasis given to these different objectives – namely, redistribution vs. incentives to take up a new job – which is reflected in the way these schemes are designed (see Box 4.3).

Box 4.3 **Key features of in-work benefit schemes**

More than half of all OECD countries now operate employment-conditional cash transfers in one form or another: Australia, Belgium, Canada, Finland, France, Germany, Hungary, Ireland, Korea, Japan, the Netherlands, New Zealand, the Slovak Republic, Sweden, the United Kingdom and the United States. The main features of these various national schemes, their distributional properties and their potential employment effects are reviewed by Immervoll and Pearson (2009). To sum up, the design of IBW schemes can be described along 2 mains dimensions:

*The characteristics of the beneficiary population*. First, IWBs can be targeted towards *individual* low-paid workers or towards low-income *families*. In the first case, incomes are assessed individually for the benefit recipient, while they are assessed jointly for the couple or the family as a whole in the second case. And although there are overlaps between low-income households and low-paid employment, the resulting beneficiary populations may differ substantially. Only 7 OECD countries operate IWB schemes that are means-tested on family incomes: Canada, France, Ireland, New Zealand, the Slovak Republic, the United Kingdom and the United States. Second, in many countries, only families *with children* have access to IWBs. This reflects a particular concern for child poverty and child well-being (Whiteford and Adema, 2007; OECD, 2008a). Third, in a small number of countries, benefits are only available to social-assistance recipients or unemployment-insurance recipients entering or re-entering employment. Australia, Belgium, Korea and Japan operate only this kind of IWB schemes (however, in Belgium, all low-wage workers benefit from reduced employees social security contributions).

*The benefit design.* First, the *generosity* of IWB payments depends on other components of redistribution policy and on institutional features of the social welfare system (*e.g.* the minimum wage, whether or not there are universal payments, family or housing benefits, etc.) and, consequently, varies substantially across countries. Second, the link between the earnings level and the benefit amount also differs from one scheme to another. Most IWBs are conditional upon the earnings level only and are *permanent*, *i.e.* paid for an indefinite period of time. They are phased in as earnings rise up to a threshold and then are gradually reduced over a range of income levels according to a *phasing-out rate*. There are 2 main variants on this basic design: *i)* in addition to the earnings level, IWBs can also be conditional upon a *minimum number of hours of work*. For instance, benefits are available to individuals working at least 16/30 hours in the United Kingdom (depending on the presence of children in the household), 19 hours in Ireland, and 20/30 hours in New Zealand (depending on the number of adults in the household). In these countries, there is no gradual phase-in, IBWs are highest for households with the lowest earned incomes; *ii)* IWBs that are restricted to previous recipients of out-of-work benefits are obviously *limited in duration*, and sometimes, are not income-dependent. For instance, in Japan and Korea, unemployed people who get a job rapidly are rewarded with a bonus calculated as a proportion of the amount of their unemployment insurance benefit entitlement that has not been used.

51. Figure 4.16 reports the main distributional aspects of IWB schemes in 11 out of the 16 OECD countries where such in-work cash transfers are in place. It refers to households where all employed individuals work in a low-paid job, earning an hourly wage equal to 40% of the average wage (or to the minimum wage when the latter is higher than 40% of the average wage).

Figure 4.16 **How much do low-paid workers get from in-work benefit schemes?**

52. In all of the selected countries, permanent IWBs reach low-income families (Figure 4.16, Panel A). In most cases, benefit payments start well below the poverty threshold, at income levels (before IWBs) varying between 6-20% of the median income in the United States (depending on the presence of children) and 49% of the median income in the United Kingdom. In addition, the benefit amount reaches its maximum level around the poverty threshold in virtually all cases, except in France and the Netherlands where the highest amount of IWBs is granted when incomes (before IWBs) are close to, or even higher than 60% of the median income. The income levels where IWBs start and/or are maximum reflect the combination of two factors: *i)* the precise targeting of these schemes, notably in countries such as Ireland, New Zealand and the United Kingdom where requirements with respect to working time prevent a number

of households from being entitled to IWBs, and *ii)* the generosity of non-employment-conditional benefits received by households before IWB payments start. This latter aspect explains, for instance, why in the United States IWBs start at very different income levels for households with and without children. It also explains the fact that in Ireland, New Zealand and the United Kingdom, the income level (before IWBs) corresponding to the maximum amount of IWB is lower than the income level from which these benefits are granted. In these 3 countries, the start of IWB payments coincides with a sharp decrease in non-employment-conditional benefits – thus avoiding a strong discontinuity in the total amount of benefits received by households.

53. Another major component of the targeting pattern is the overall range of incomes over which benefits are available, in that it determines the size of the recipient population and the fiscal cost of such schemes. In this respect, there are sizable differences between countries. In Finland, France, the Netherlands and the Slovak Republic, the phasing-out of IWBs ends up after the maximum level of income that a household containing only low-wage workers can reach (when working 120 hours per week), which is quite far above the median income in all of these four countries. By contrast, in Ireland, New Zealand, the United Kingdom and the United States, benefit payments end between 60% and 75% of the median income (except for childless households in the United States, where they stop much earlier). As a result, the maximum amounts of benefit are much more generous in these four countries, varying from almost 9% of the median income in New Zealand to as much as 18% of the median income in Ireland. And while benefits payments are smaller at the poverty threshold (essentially because households earnings are higher), they still make a difference and significantly help low-income families to reach this threshold. Likewise, IWBs that are only available to previous recipients of out-of-work benefits and for a limited duration tend to be quite generous (Figure 4.16, Panel B). On the other hand, in the four countries that operate regular IWB schemes over a large range of household incomes (Finland, France, the Netherlands and the Slovak Republic), the amounts granted remain below 4% of the median income. In these cases, the behavioural responses are unlikely to be very significant.

54. To *sum up*, these various national schemes effectively reach low-income families, be they individual-based or mean-tested on family incomes. But given budget constraints, programmes need to be tightly targeted for the benefit level to be generous enough to have a real impact on in-work poverty. In this respect, mean-tested IWBs have a major advantage: they make it easier to reach *only* low-income families, witnesses the Earned Income Tax Credit (EITC) in force in the United States, and to a lesser extent, IWBs available in Ireland, New Zealand and the United Kingdom. Requirements with respect to working time or previous employment status also allow a tighter targeting of IWB schemes. But in terms redistribution, these additional entitlement criteria have the major drawback of excluding a large proportion of the most disadvantaged families from the beneficiary population, while a number of median-income families may be eligible to the programme (in particular, when the benefits in question are not mean-tested on family incomes). In fact, these eligibility conditions tend to shift IWBs away from redistribution, towards a work-incentive policy.

*Well-designed IWBs may be successful in reducing poverty, as well as a cost-effective redistribution instrument*

55. Strengthening work incentives is a key objective of IWB schemes and their effectiveness in redistributing resources towards the most disadvantaged families also depends on their employment effect. While mean-tested benefits have more favourable distributional properties, they also tend to damage work incentives of other potential earners in the household. Individual-based IWBs avoid the adverse effect. Still, these schemes may reduce financial incentives to move up the wage ladder and thus, to increase work intensity on the intensive margin (as well as, to invest in human capital). However, empirical evidence suggests that, provided that IWBs are large enough to create a sizeable difference between welfare income and work income, their overall effect on employment is positive although relatively small in most cases

(see *e.g.* Blundell *et al.*, 2000; Blundell and Hoynes, 2004; Brewer *et al.*, 2006; Ellwood, 2000; Eissa and Hoynes, 2004; Grogger, 2003; Hotz and Scholz, 2003; Keane and Moffitt, 1998; Meyer and Rosenbaum, 2001 and Michalopoulos *et al.*, 2005). The positive effects of additional employment clearly outweigh the costs created by reduced incentives to work more, even in the case of mean-tested benefits.

56. Overall, these schemes may be successful in reducing poverty. For instance, Holt (2006) reports that, in 2003, the EITC lifted 4.4 million people in low-income, working families out of poverty, more than one-half of them children. And this scheme lifts more children out of poverty than any other social program or category of programs. Without it, the poverty rate among children would be 25 percent higher (Greenstein, 2005). Another study found that from 1995 through 1999, the EITC reduced the overall poverty rate by 1.5 percentage points, even though only about one third of poor households qualify for the credit (Hoffman and Seidman, 2003). Moreover, the total poverty gap –the aggregate difference between poor families' resources and the poverty threshold– for families with children would have been 20 percent higher in 1999 without the EITC (Ziliak, 2004).

57. Moreover, compared to other redistribution policies, the efficiency cost of IWB schemes can be very small relative to the redistribution achieved. These schemes have often been assessed in terms of the cost "per job created", which is generally high. But such cost assessments fail to fully account for the favourable distributional effects of IWB policies and a more comprehensive approach should also take into account the potential benefits associated with the reduction in inequality and in-work poverty. Using such an approach, some recent results point towards rather low overall costs "per dollar transferred", especially as compared with more traditional redistribution policies, which may entail large "efficiency losses" if they strongly damage work incentives. For instance, Immervoll *et al.* (2007) suggest that the cost to taxpayers of redistributing one euro in the form of an in-work benefit can be as low as one euro, implying an efficiency cost close to zero. Because low-income workers tend to be more responsive to financial incentives than middle or high-income earners, there is a distinct possibility that the additional tax burden on higher-income earners is in fact relatively small if the savings from each additional job are large (out-of-work benefits are no longer payable). Nonetheless, a number of studies also indicate that the effectiveness of IWB-type policies varies substantially across countries.

*The effectiveness of IWBs also depends on other components of national redistribution policies*

58. A precise and well-conceived policy design is not enough for achieving an efficient targeting that would guarantee a meaningful degree of redistribution – *i.e.* a reduction of income disparities between working recipients and non-recipients , as well as increased work incentives at the bottom of the wage ladder. In this respect, the distribution of in-work earnings in the population, and particularly, the number of low-wage earners who are potential beneficiaries are critical aspects (see Immervoll and Pearson, 2009). A proper targeting of the benefits is less straightforward if income differences are quite small to begin with, but this also reduces the scope for financing IWBs in an effective way. In essence, many of those benefiting from the IWB payments are at the same time paying for its financing: they face higher tax burdens that partly offset the benefit payments.[6] Conversely, a highly dispersed income distribution makes it relatively easy to distinguish recipients of the IWB from higher-income groups contributing to the financing of the scheme. Moreover, the required revenue can then be raised by slowly increasing tax burdens over a wide income range. In such circumstances, IWB schemes can be a cost-effective tool to redistribute resources towards the most disadvantaged families (see Box 4.4). By contrast, IWBs are likely to be either very expensive or ineffective in countries where high out-of-work benefits or high minimum wages tend compress the earnings distribution at the bottom of the wage ladder.

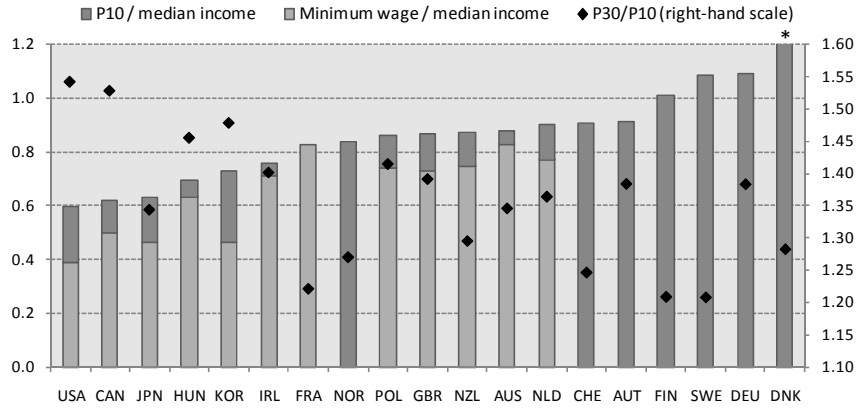
6. Indeed, if IWBs represent an additional transfer, *i.e.* if they are introduced without cutting back other benefits, then financing usually takes place by increasing tax burdens for higher-income groups.

Box 4.4 **Effectiveness of IWBs and earnings distribution at the bottom of the wage ladder**

The effectiveness of IWBs depends on a number of key aspects, including the ex-ante distribution of market earnings, the tax system as well as the non-employment benefits. For instance, in a study comparing the effect of stylised IWBs in Germany, Sweden, the United Kingdom and the United States, Bassanini *et al.* (1999) suggest that such instruments are less suited for the Swedish or the German economy than for UK or US context. IWB programmes, where workers with higher earnings finance the tax credits for the low paid, produce better overall effects –both in terms of total labour supply, unemployment and welfare– in countries with wider earnings distribution and lower marginal taxes (e.g. the United States and the United Kingdom). By contrast, the combination of compressed earnings distribution, high reservation wages and high taxes on labour makes the introduction of IWBs costly in Germany, and especially in Sweden, with moderate (or even negative) overall labour supply effects. Likewise, Considering the introduction of a simple IWB in 15 European countries, Immervoll *et al.* (2007) find that the cost-effectiveness of IWBs varies sharply across countries. Paying a 1-euro transfer to low-income workers would cost higher-income groups around 1 euro in the United Kingdom and even less than 1 euro in Ireland, both countries with relatively wide earnings distributions at the bottom of the wage-ladder. In other words, these results suggest that there is no "efficiency loss" associated with the IWB in these countries (and even an "efficiency gain" in Ireland). By contrast, in Finland and Sweden, both countries with compressed earnings distributions, the hypothetical 1-euro IWB would be very expensive, costing as much as 5 Euros in Finland and 4 Euros in Sweden.

Interestingly, in countries with relatively narrow earnings distribution at the bottom of the wage ladder, the ratio between very low wages –as measured by the first decile of the earnings distribution– and the median income tends to be relatively high, meaning that these low wages may allow families with very low earnings potential to reach a "decent" living standard (see Figure below). Therefore, this reduces the need for IWB-type measures in these countries. Instead, policy actions should probably focus on other components of the redistribution policy, such as labour taxes, minimum wages or out-of work benefits.

**Earnings distribution at the bottom of the wage ladder**




Note: P10 and P30: first and third deciles of the wage distribution. Median income for single workers working full-time. Earnings refer to gross earnings of full-time workers. Data refer to 2004 for Germany. In France, P10 and the minimum wage are equal. There is no statutory minimum wages in Austria, Denmark, Finland and Germany, Norway, Sweden and Switzerland.

59. Yet, a minimum wage may prevent employers from "pocketing" the value of IWBs by lowering wages. Therefore, such a wage floor can constitute a useful complement to IWBs, provided that it is set to a moderate level. For instance, In the United States, while minimum wage work plus the EITC provided $1,154 more than the poverty level for a family of three in 1995, the same family fell $1,000 short of the poverty threshold in 2005, because the minimum wage has not increased between 1997 and 2005, because the minimum wage has not increased in the United States between 1997 and 2005 (Holt, 2006). But overall, there is no strong evidence that the EITC has depressed wage rates significantly at the bottom of the wage ladder. As noted by Holt (2006), one reason is that EITC-eligible workers are a minority in each rung of the labour market, which limits the ability of the EITC to affect wages marketwide. Moreover,

employers would find it difficult to pay different wages to workers in similar jobs on the basis of their EITC eligibility. Nonetheless, one study does find that a 10 percent increase in a state EITC was associated with a 4 percent drop in wages of high school dropouts and a 2 percent decline in wages for those with only a high school diploma (Leigh, 2003). Another recent study concludes, however, that expansions to the EITC during the 1990s had little apparent effect on hourly wages near the bottom of the wage distribution (Eissa and Nichols, 2005).

**Conclusion**

60. Policies to fight poverty have to fulfil several objectives. They should provide adequate safety nets to individuals with weak employment prospects and who may experience recurrent spells of unemployment before finding a stable job, while also ensuring that it pays to work. They also should ensure that working full-time in low-paid employment allows achieving decent living conditions, without damaging demand for low-skilled workers.

61. Few OECD countries have been successful in addressing these multiple challenges. Poverty rates among jobless people are relatively high in many countries, and while full-time employment generally allows childless households to achieve adequate living conditions, this is often not the case for families with children. In a number of countries, disposable income of couples with children does not exceed 60% of the median income when both spouses are working full-time in low-paid employment. In the current economic context, where labour market conditions are worsening in most member countries, there are few margins for these families to remain above the poverty threshold, even if both spouses stay employed but face a reduction of hours worked. Moreover, the proportion of two-earner couples could decrease, notably among low-wage-earner families whose employment situation tends to be more sensitive to economic downturns. This would in turn increase in-work poverty in many countries, where one full-time job at the bottom of the wage ladder is not enough to cross the poverty threshold.

62. And for lone parents working in low-pay employment, the situation is even more critical: full-time work and poverty coexists in many countries. For these families, employment constitutes a solid path towards economic self-sufficiency in only 3 countries: Australia, Ireland and the United Kingdom. In these countries, while out-of-work benefits are relatively generous by OECD standards, full-time work still brings substantial income gains, since average effective tax rates are not overly high. In Ireland and the United Kingdom, in-work benefit payments play a key role, adding significantly to available income of families with a low earnings potential. When they have a strong distributional component, IWB schemes have the potential to be an effective anti-poverty tool, provided that they are well-designed. In recessionary periods, they can become a major element of the toolbox of policies to fight in-work poverty, through supplementing the incomes of low-wage workers facing a decrease in their working hours and earnings.

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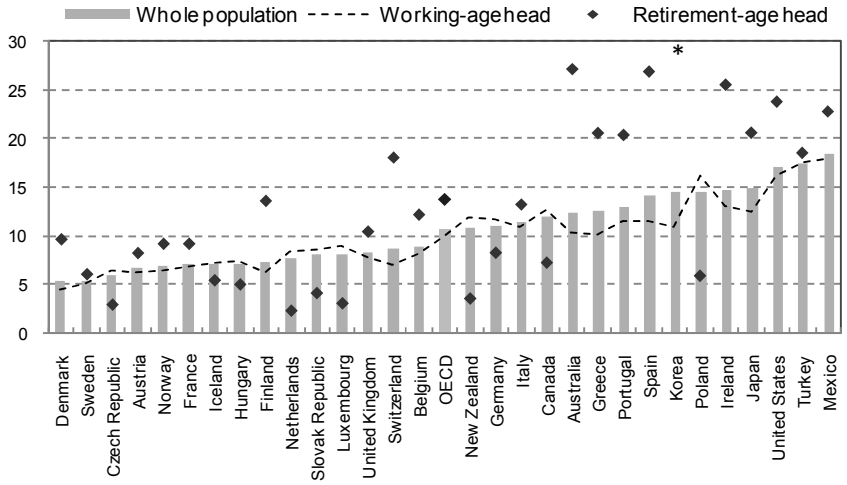
## FIGURES AND TABLES

Figure 4.1 **Poverty in OECD countries**

Panel A. Poverty rates [a], mid-2000s




Panel B. Poverty and unemployment rates, mid-2000s

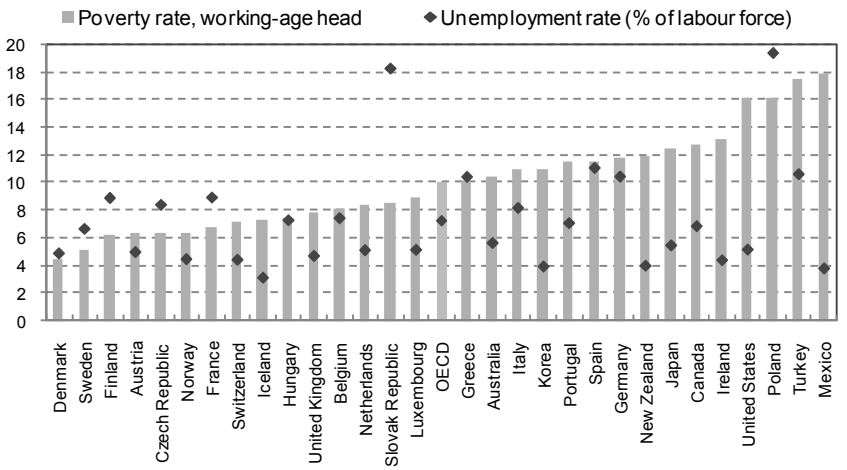
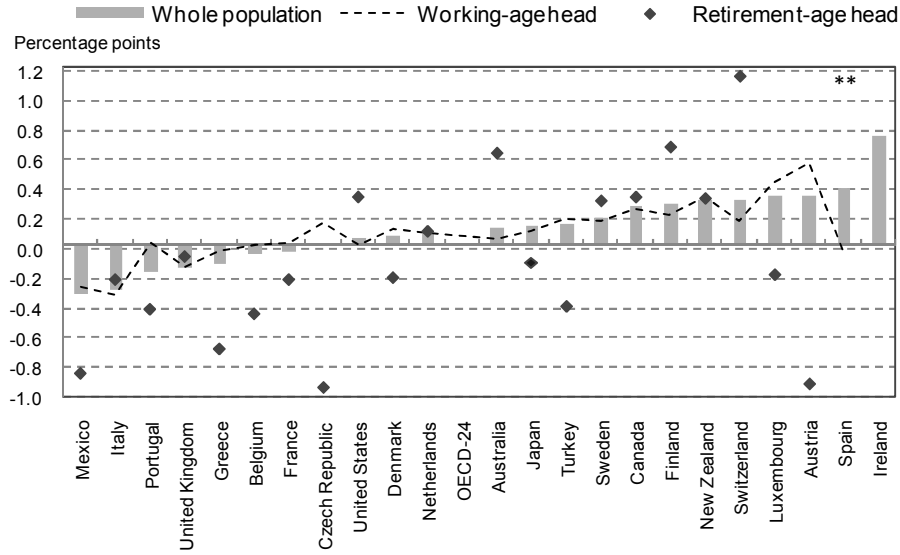


Figure 4.1 **Poverty in OECD countries** *(cont.)*

Panel C. Average annual change in poverty rates, mid-1900s to mid-2000s[b]




Note:

* In Korea, the poverty rate for persons living in households with a retirement-age head is equal to 48.5 %.

** In Spain, the average annual change in poverty rate for persons living in households with a retirement-age head is equal to 3.4 percentage points.

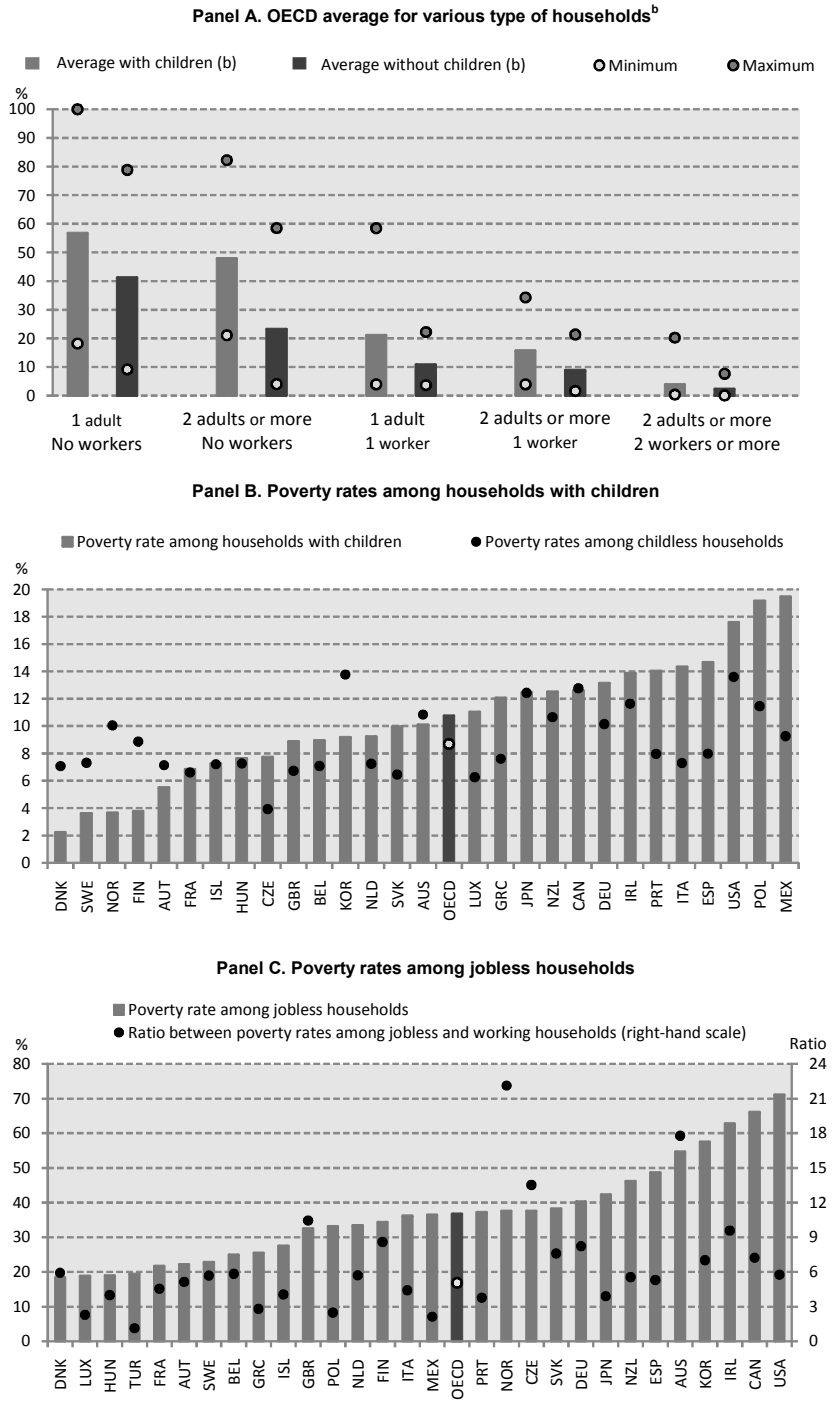
a) Percentage of individuals living in households with disposable income below 50 % of the median income. Poverty rates are calculated for the whole population, persons living in households with a working-age head and persons living in households with a retirement-age head respectively.

b) Data refer to changes from the mid-1990s to around 2000 for Austria, Belgium, the Czech Republic, Ireland, Portugal and Spain and to changes from 2000 to 2004 for Switzerland.

*Source*: OECD (2008a); OECD Labour force Statistics database.

Figure 4.2 **Poverty rates among the working-age population for various types of household[a]**

Mid-2000s

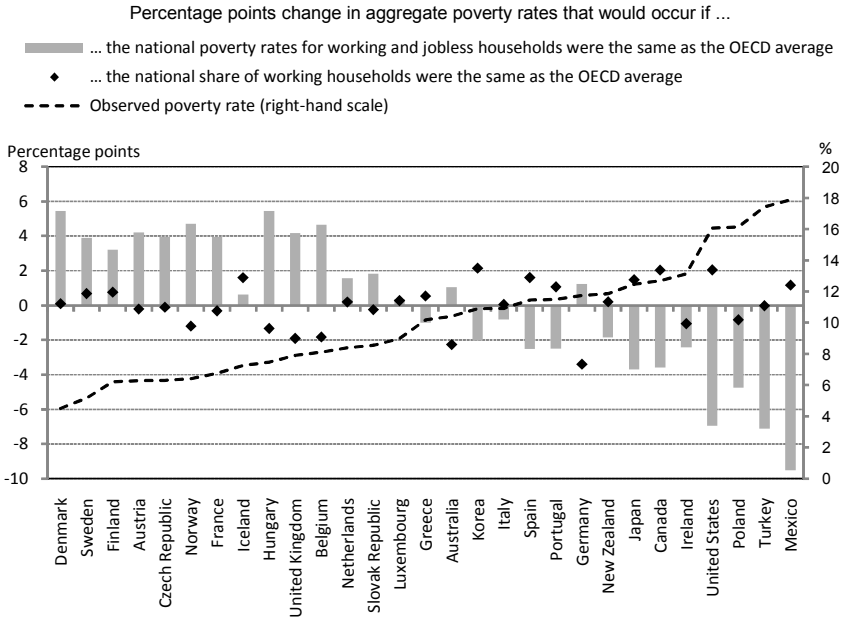



Note:
a) Among all individuals living in households with a head of working-age, percentage of individuals living in households with disposable income below 50 % of the median income.
b) OECD unweighted average.
*Source*: OECD (2008a).

Figure 4.3 **Cross-country differences in poverty rates among households of working-age**[a]

Panel A. Poverty rates[b]

*Mid-2000s*




Panel B. Average annual changes in poverty rates[c]

*Mid-1990s to mid-2000s*[d]

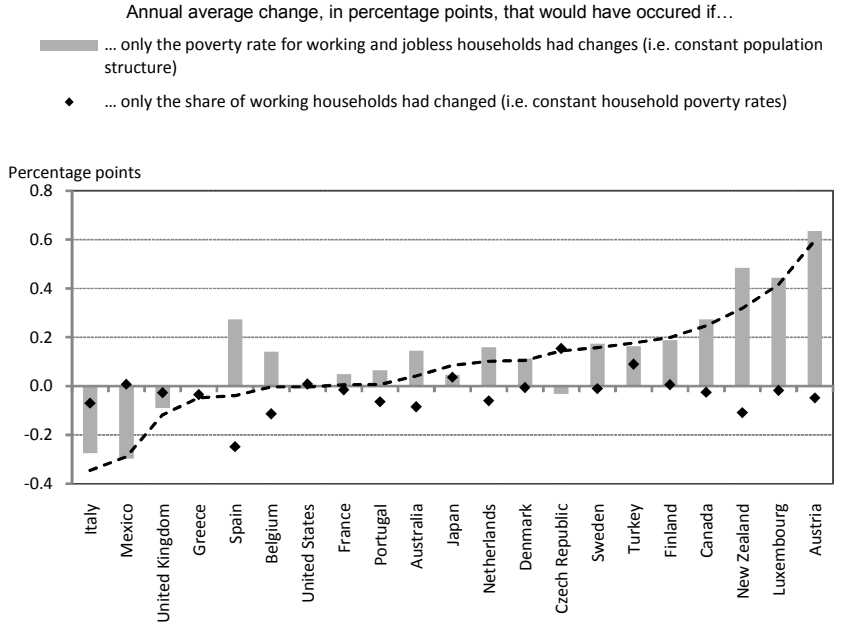


Figure 4.3 **Cross-country differences in poverty rates among households of working-age**[a] *(cont.)*

Note:

a) Population is split over households with at least one worker and jobless households.

b) **Countries are ranked by increasing observed (aggregate) poverty rates**.

**Reading note**: In Sweden, the aggregate poverty rate would be 4 percentage points higher than that observed, if the poverty rates for both jobless and working households were the same in this country as those observed on average in the OECD area. Sweden would also exhibit a slightly higher (by less than 1 percentage point) aggregate rate of poverty, if this country had exactly the same share of working households as that observed on average in the OECD area.

c) **Countries are ranked by increasing observed change in (aggregate) poverty rates**.

**Reading note**: In Spain, the aggregate poverty rate would have increased by more than 0.2 percentage point (on a yearly basis), if the share of working households had remained constant over the corresponding period. By contrast, the aggregate rate of poverty would have decreased by more than 0.2 percentage point (on a yearly basis), if the poverty rates for both jobless and working households had remained constant over the corresponding period.

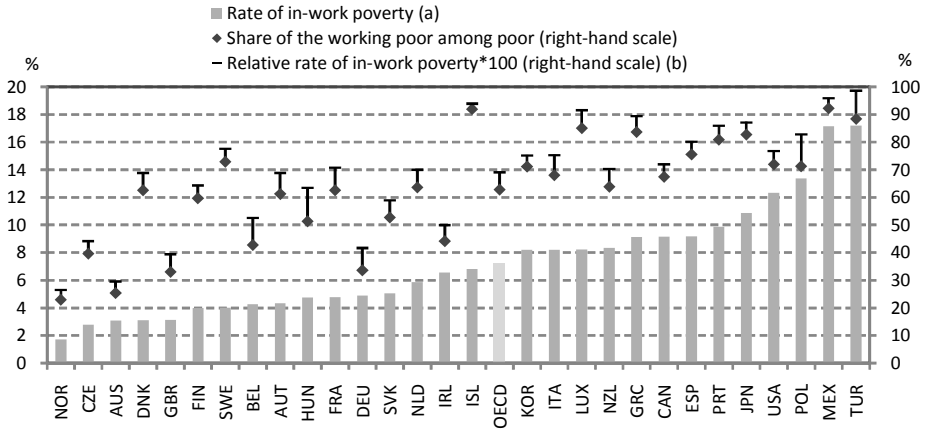
d) Data refer to changes from the mid-1990s to around 2000 for Austria, Belgium, the Czech Republic, Portugal and Spain.

*Source:* OECD (2008a).

Figure 4.4. **In-work poverty in OECD countries**

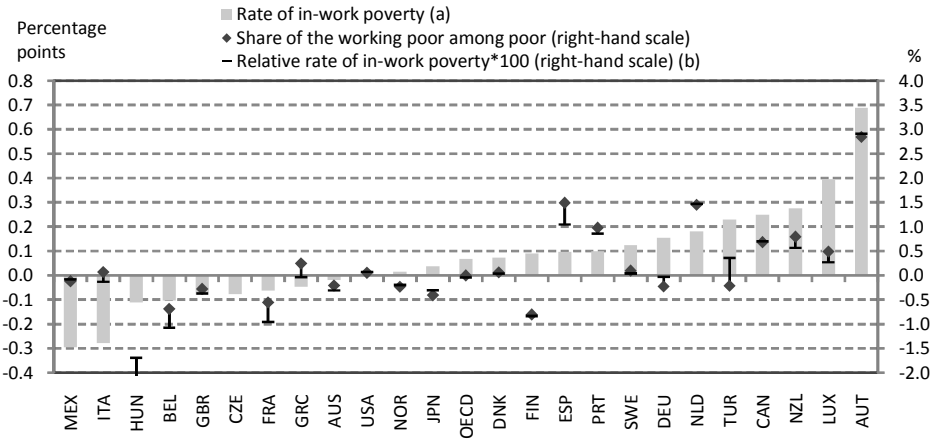
Panel A. In-work poverty rates and shares of working poor among all individuals living in households with a head of working-age

*Mid-2000s*




Panel B. Average annual changes in rates of in-work poverty and in shares of working poor among the poverty population of working-age

*Mid-1990s to mid-2000s*[c]




Note:

a) Percentage of individuals living in households with disposable income below 50 % of the median income, among all individuals living in a given type of household with a head of working-age and at least one worker.

b) Rate of in-work poverty divided by the overall poverty rate in households with a head of working age (multiplied by 100).

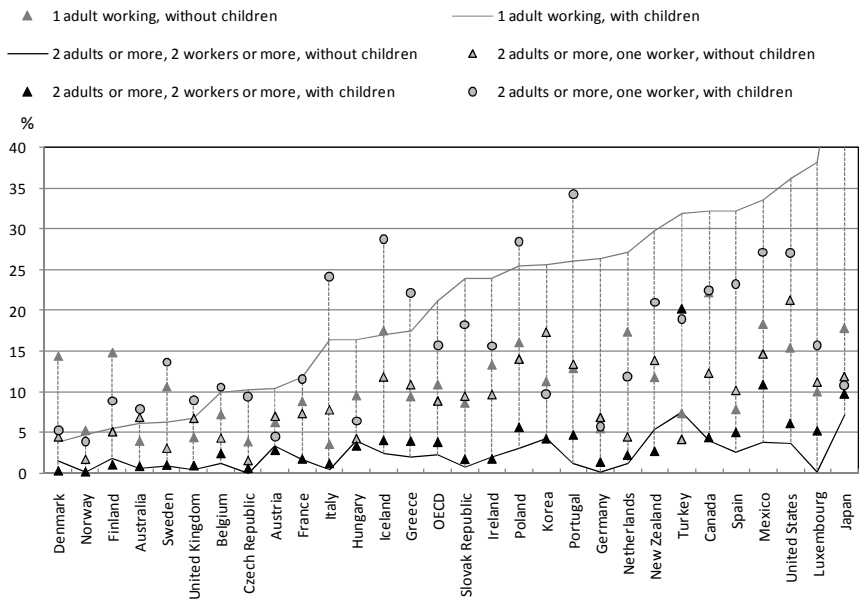
c) Data refer to changes from the mid-1990s to around 2000 for Austria, Belgium, the Czech Republic, Portugal and Spain.

*Source*: OECD (2008a).

**Figure 4.5 In-work poverty risk varies strongly according to family composition**

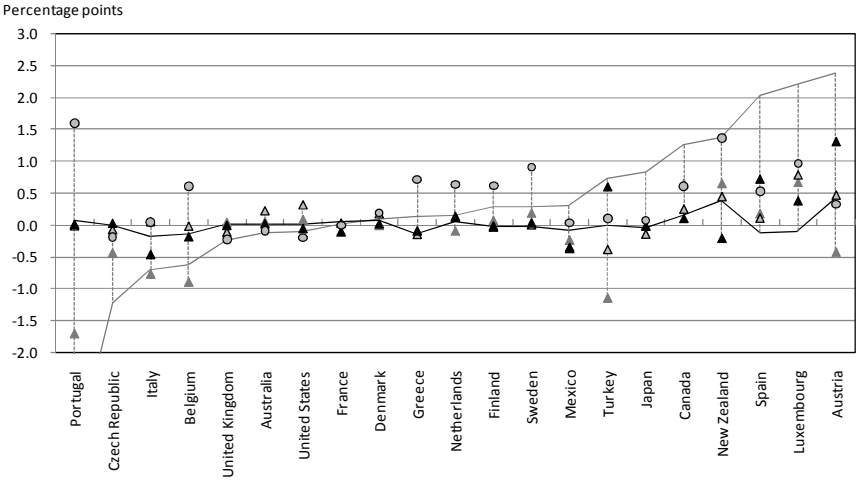
Panel A. In-work poverty rates[a]

*Mid-2000s*




Panel B. Average annual changes in in-work poverty rates

*Mid-1990s to mid-2000s*[b]




Note:

a) Among all individuals living in a given type of household (1 adult-member × with/without children, 2 adult-members × one/two workers × with/without children), percentage of individuals living in households with disposable income below 50 % of the median income.

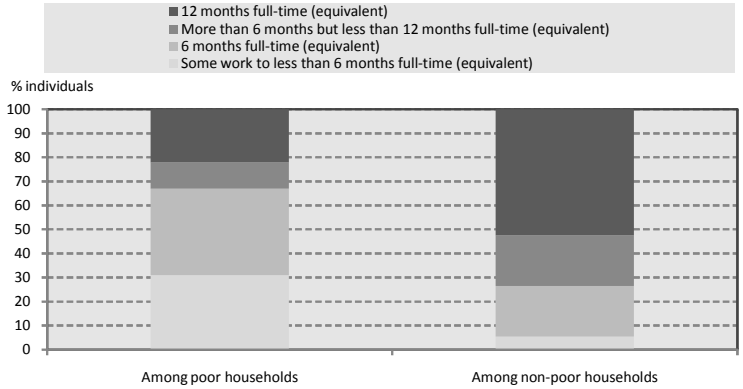
b) Data refer to changes from the mid-1990s to around 2000 for Austria, Belgium, the Czech Republic, Portugal and Spain.

*Source*: OECD (2008a).

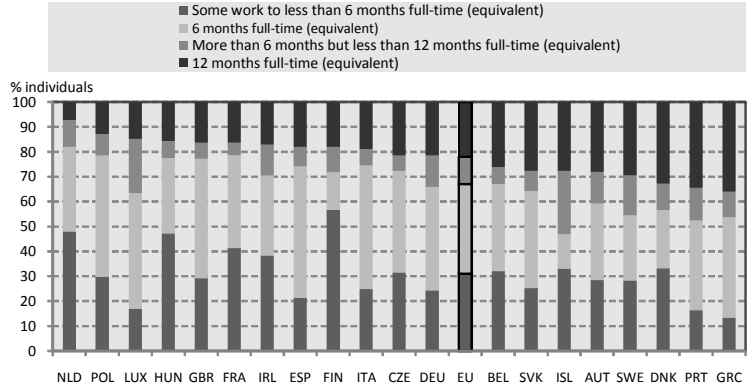
Figure 4.6 **Average time spent at work over the year and corresponding rates of in-work poverty, 2005**

Panel A. Average time spent at work for individuals living in households with at least one worker[a]

Population aged 20-64, average over 20 European countries




Panel B. Average time spent at work for individuals living in a poor household with at least one worker[a]




Panel C. In-work poverty rates by working intensity[b]

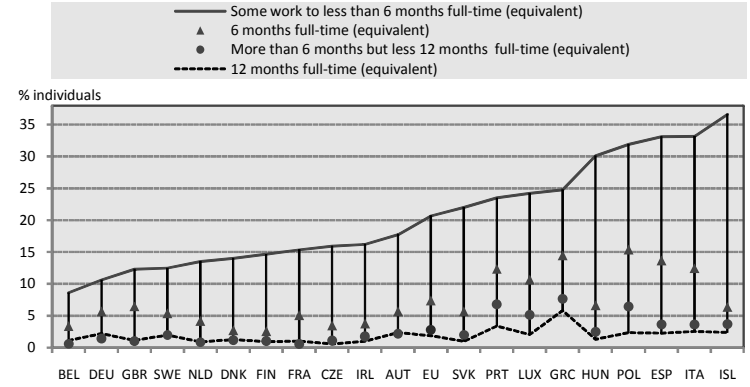


Figure 4.6 **Average time spent at work over the year and corresponding rates of in-work poverty, 2005** *(cont.)*

Note:

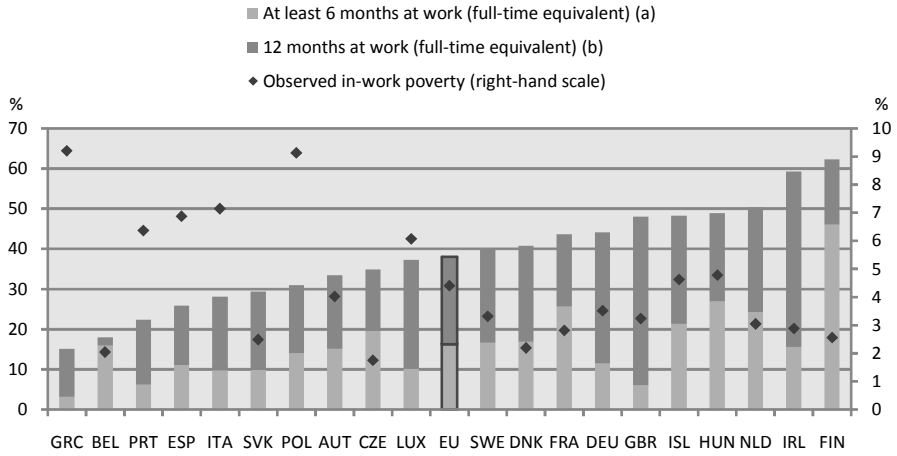
a) **Reading note, Panel A**: among all individuals aged 20-64 and living in a poor household with at least one worker, 30% live in households where the *average* time spent at work over the year, per member living in the household, is less than 6 months (in full-time equivalent months).The total number of hours spent at work by head and spouse (when relevant) has been computed for each household, and then, has been divided by the number of adults living in the household in question (head and spouse, when relevant, regardless of the employment status of the spouse), to obtain the *average* amount of hours worked per adult in each household. Calculations have been made separately for poor and non-poor households.

b) Among all individuals living in households with at least one worker, share of individuals with less than 50% of the median disposable income. The calculation is done separately by time spent at work per individual as defined in a).

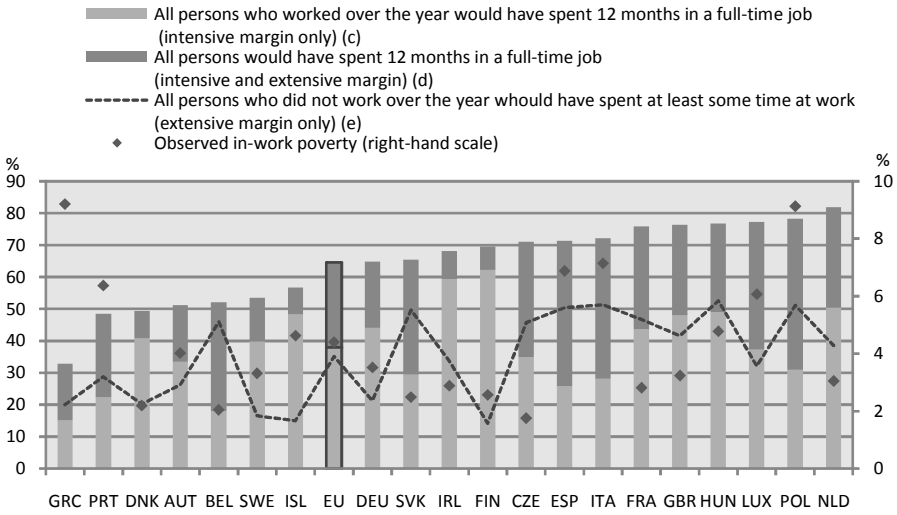
*Source*: EU-SILC.

Figure 4.7. **Work participation at the extensive and intensive margins and in-work poverty rates, 2005**

Panel A. Percentage reduction in the rate of in-work poverty that occurs when assuming that all persons who worked over the year would have spent …




Panel B. Percentage reduction in the rate of in-work poverty that occurs when assuming that…




Note:

a) Percentage reduction when applying the poverty rate for households working at least 6 months full-time equivalent (at least 12 months for two-earner couples) to households working less than 6 months full-time equivalent (less than 12 months for two-earner couples).

b) The cumulated two bars show the percentage reduction when applying the poverty rate for households working 12 months full-time equivalent (24 months for two-earner couples) to households working less than 12 months full-time equivalent (24 months for two-earner couples).

c) Percentage reduction when applying the poverty rate for households working 12 months full-time equivalent (24 months for two-earner couples) to households working less than 12 months full-time equivalent (24 months for two-earner couples).

d) Percentage reduction when applying the poverty rate for single working 12 months full-time equivalent to single households working less than 12 months full-time equivalent and the poverty rate for two-earner couples working 24 months full-time equivalent to both one- and two-earner couples.

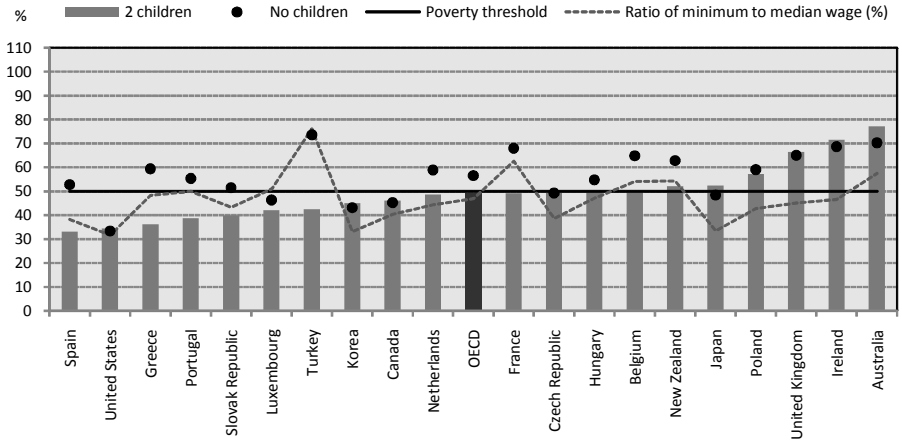
e) Percentage reduction when applying the observed poverty rate for two-earner couples to one-earner couples.

*Source*: EU-SILC.

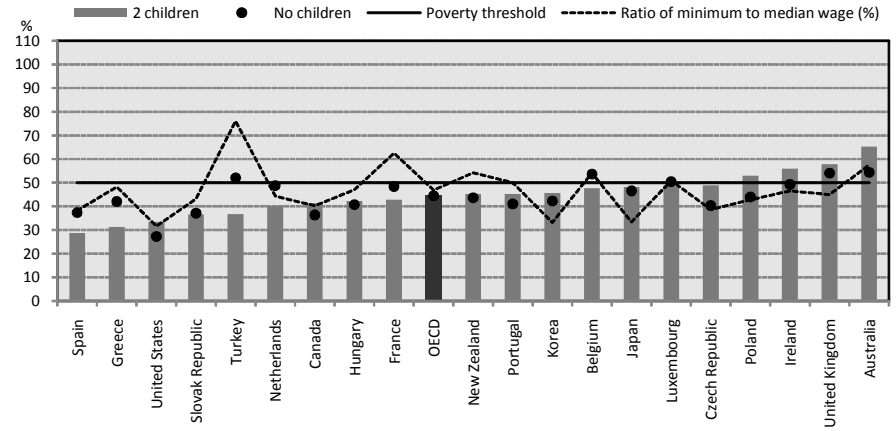
Figure 4.8 **Net incomes of full-time minimum wage earners**[a]

Percentage of the median equivalised income, 2005

Panel A. Single persons




Panel B. One-earner couple



C. Two-earner couple

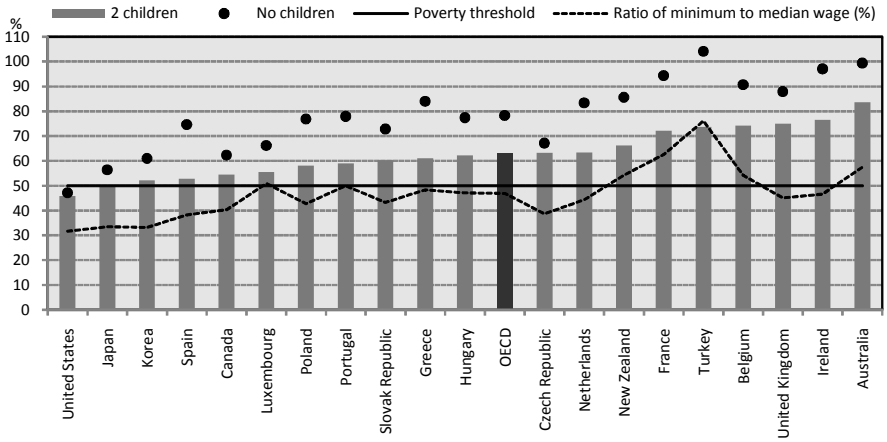



Figure 4.8 **Net incomes of full-time minimum wage earners**[a] *(cont.)*

Note:

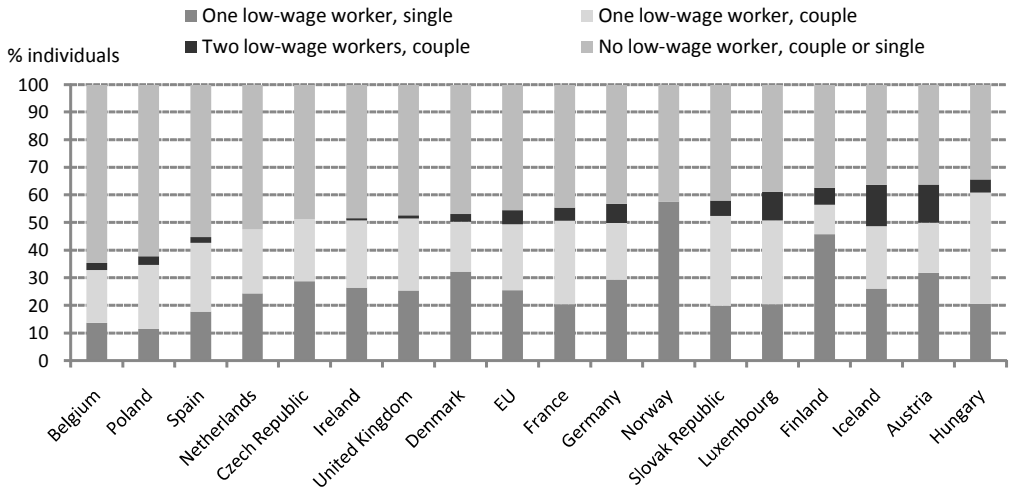
Countries are ranked by increasing net income of full-time minimum wage earners in households with 2 children.

a) Full-time employment corresponds to 40 hours of work per week and per worker. See Box 4.2 for details on the OECD tax-benefit model assumptions.

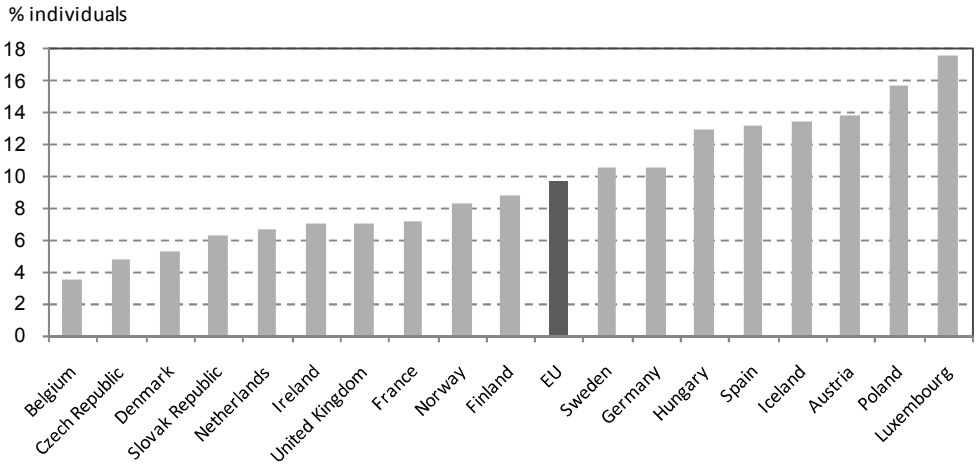
*Source*: OECD tax-benefit models.

Figure 4.9 **Overlap between in-work poverty and low-paid employment, 2005**

Panel A. Earnings status of individuals aged 20-64 living in poor households with at least one worker




Panel B. Low-wage workers living in a poor household, as a percentage of all workers with hourly wages below the lowest quintile threshold of the wage distribution




Note:

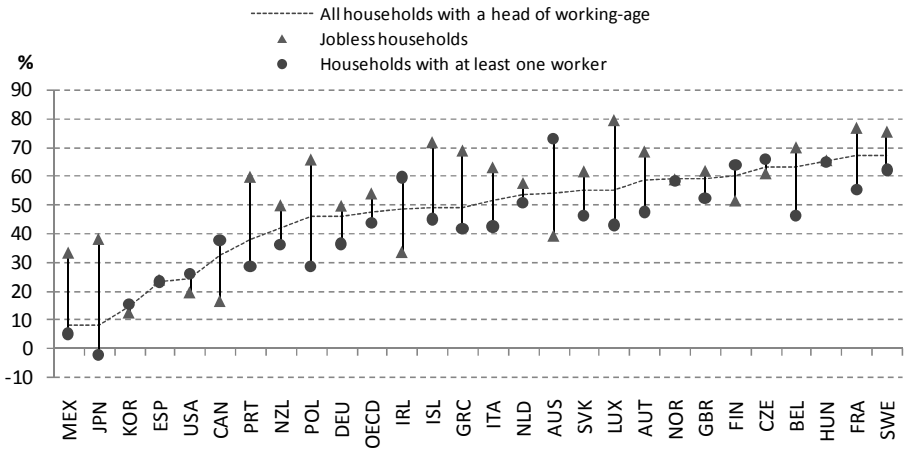
In Panel A, countries are ranked by decreasing percentage of individuals living in poor households with no low-wage worker (couple or single).

*Source*: EU-SILC.

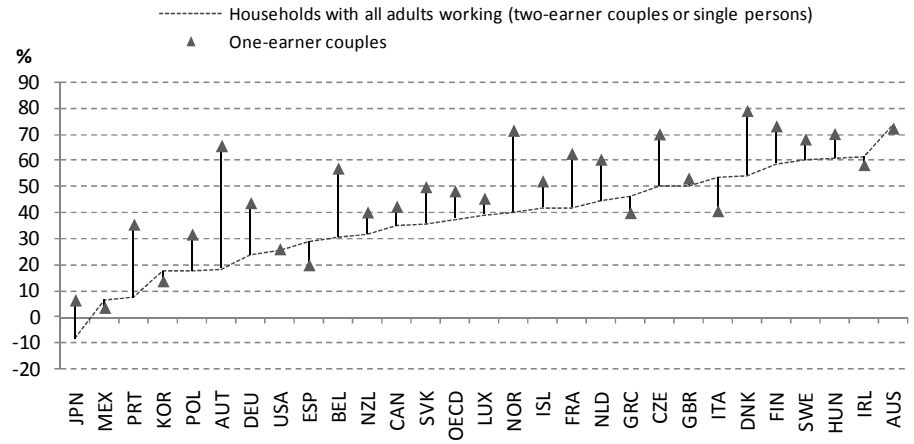
Figure 4.10 **By how much do social transfers reduce poverty?**

Percentage reduction of poverty rates operated by net social transfers[a], mid-2000s

Panel A. Poverty rates among the working-age population, depending on employment status[b]




Panel B. In-work poverty rates and underemployment at the household level[c]




Note:

a) Difference between poverty rates before and after social transfers, as a percentage of the poverty rate after social transfers. The poverty rates before and after transfers are calculated on market-income and disposable income, respectively.

b) The poverty rate is calculated as the percentage of individuals living in households with income below 50 % of the median income for all individuals living in all households with a head of working age, individuals living in households with no workers, individuals living in households with at least one worker. Countries are ranked by increasing poverty rate for all households with a head of working-age.

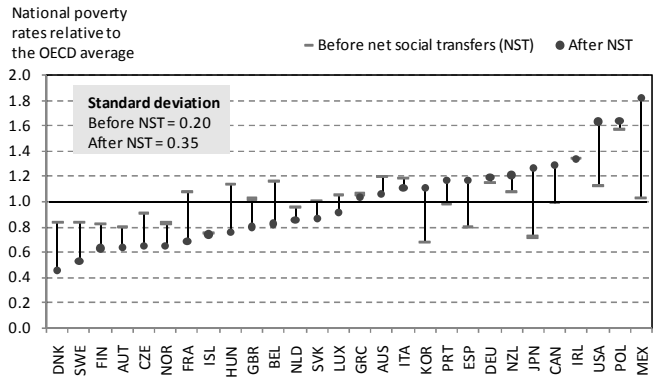
c) The poverty rate is calculated as the percentage of individuals living in households with income below 50 % of the median income for all individuals living in households with a head of working age and all members working (singles or two-earner couples), and individuals living in one-earner couples. Countries are ranked by increasing in-work poverty rate for households with all adults working.

*Source*: OECD (2008a).

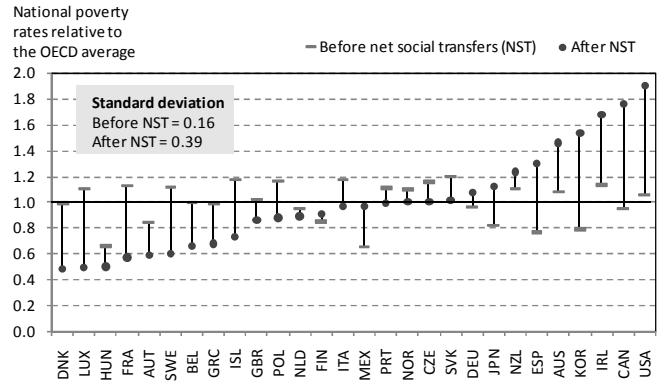
Figure 4.11 **How much do social transfers affect cross-country differences in poverty rates?**

Poverty rates relative to the OECD average, mid-2000s

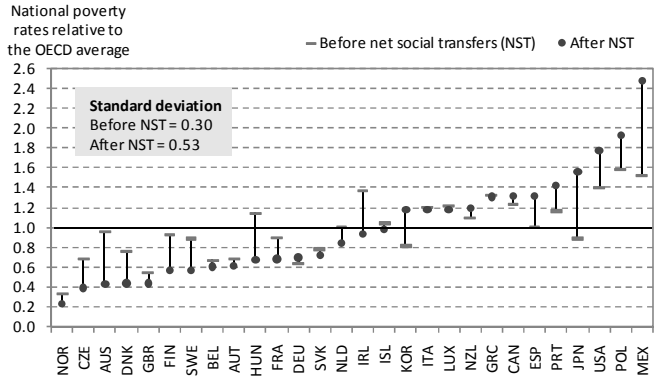
Panel A. Poverty among the whole working-age population[a]




Panel B. Poverty among jobless households[a]




Panel C. In-Work poverty[a]

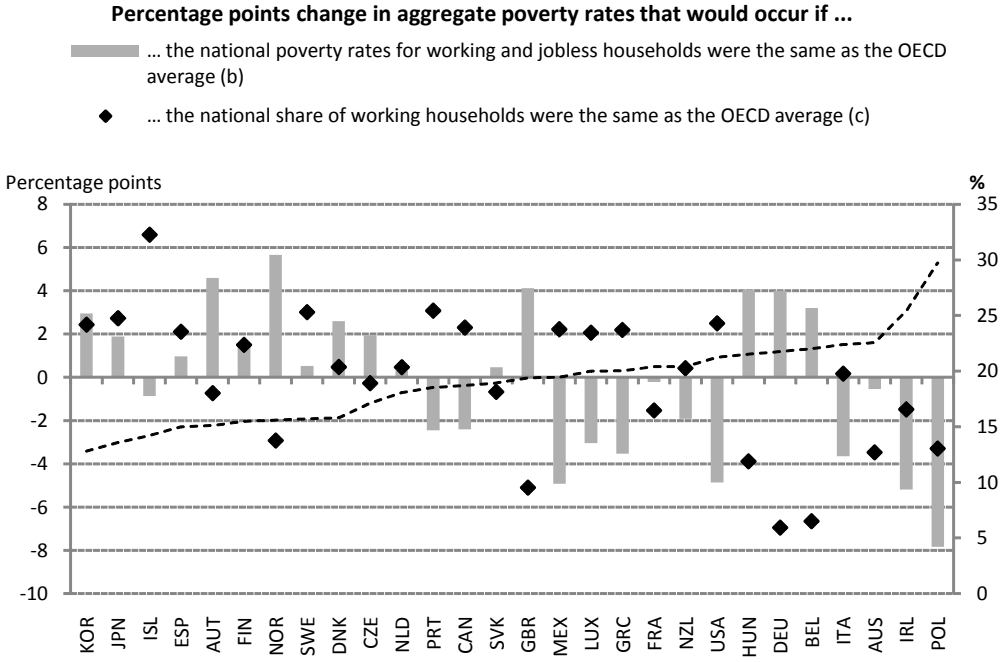



Note:

a) Poverty rates before and after transfers are calculated on market income and disposable income, respectively. In both cases, poverty rates are calculated as the percentage of individuals living in households with income below 50 % of the median income for all individuals living in all households with a head of working age (Panel A), individuals living in households with no workers (Panel B), individuals living in households with at least one worker (Panel C). Countries are ranked by increasing poverty rate after net social transfers.

*Source*: OECD (2008a).

Figure 4.12 **Cross-country differences in poverty rates before net social transfers and labour market performances**[a], mid-2000s




Note:

a) Population is split over households with at least one worker and jobless households. Countries are ranked by increasing observed (aggregate) poverty rates before social transfers.

Reading note: In the United Kingdom, the aggregate poverty rate before social transfers would be 4 percentage points higher than that observed, if the poverty rates for both jobless and working households were the same in this country as those observed on average in the OECD area. The United Kingdom would also exhibit a lower aggregate rate of poverty (by 5 percentage points), if this country had exactly the same share of working households as that observed on average in the OECD area.

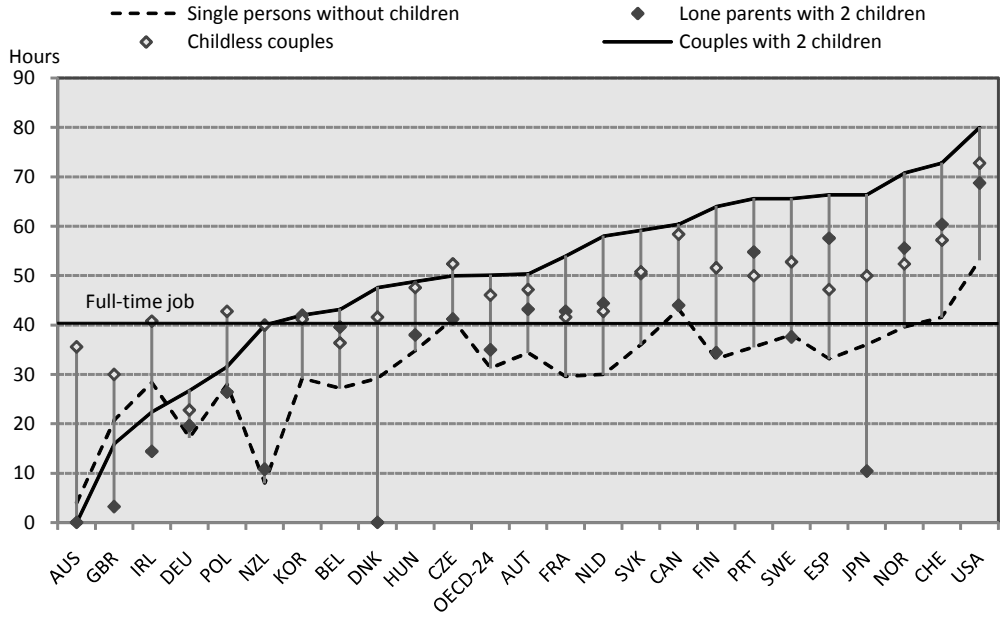
b) Correlation between the observed poverty rate before transfers and the recalculated poverty rate assuming that the national poverty rates for working and jobless households are the same as the OECD average: 0.53***.

c) Correlation between the observed poverty rate before transfers and the recalculated poverty rate assuming that the national share of working households is the same as the OECD average: 0.61***.

*Source*: OECD (2008a).

Figure 4.13 **Total number of working hours necessary to reach the poverty threshold**[a], 2005

Individuals working in a low-paid job, earning 40% of the average wage on an hourly basis



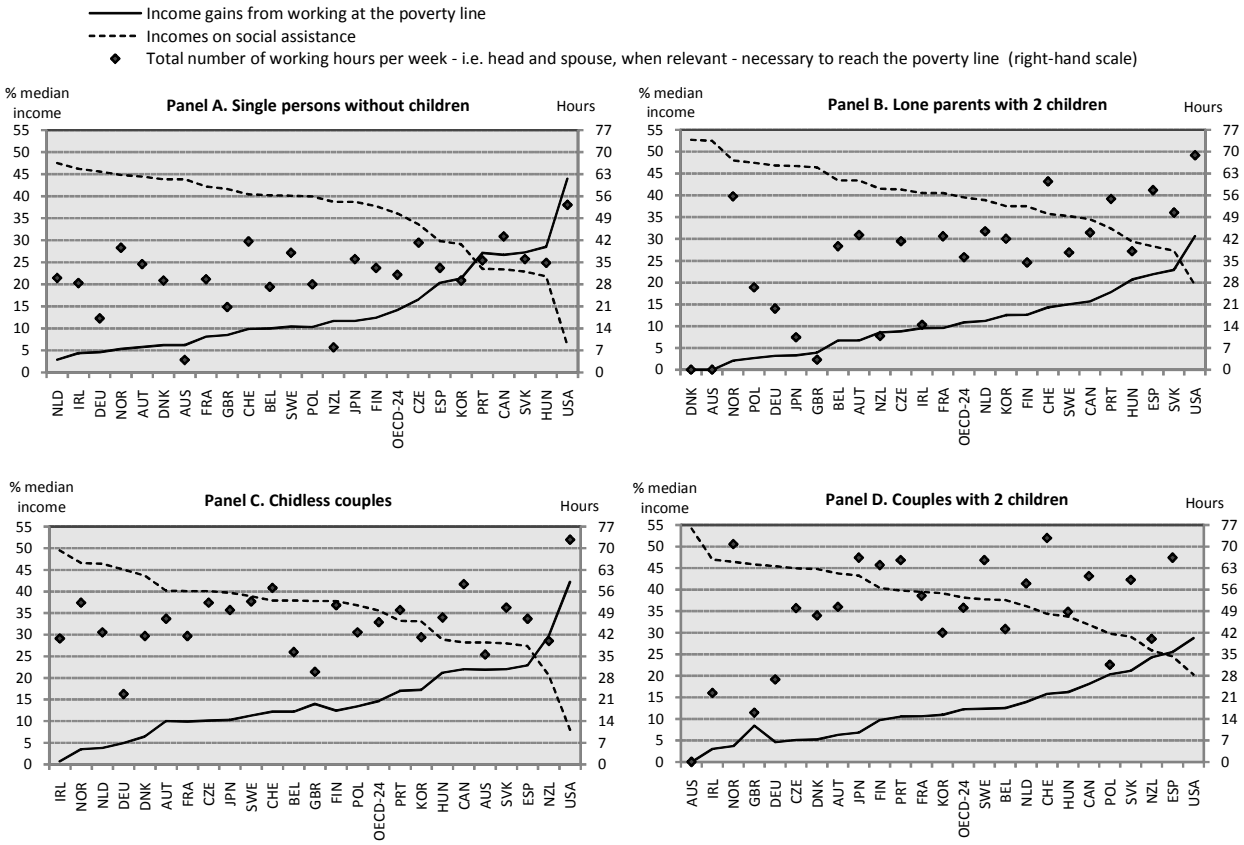

Note:

a) The poverty threshold is set at 50% of the median equivalised income. See Box 4.2 for details on the OECD tax-benefit model assumptions.

*Source*: OECD tax-benefit models.

Figure 4.14 **Net additional incomes brought by low-paid employment, as compared with incomes from social assistance[a], 2005**

Households with net income equal to 50% of median income when at least one adult is working in a low-paid job, with an hourly wage equal to 40% of the average wage




Note:

Countries are ranked by increasing income gains at the poverty line.

a) The poverty threshold is set at 50% of the median equivalised income. See Box 4.2 for details on the OECD tax-benefit model assumptions.

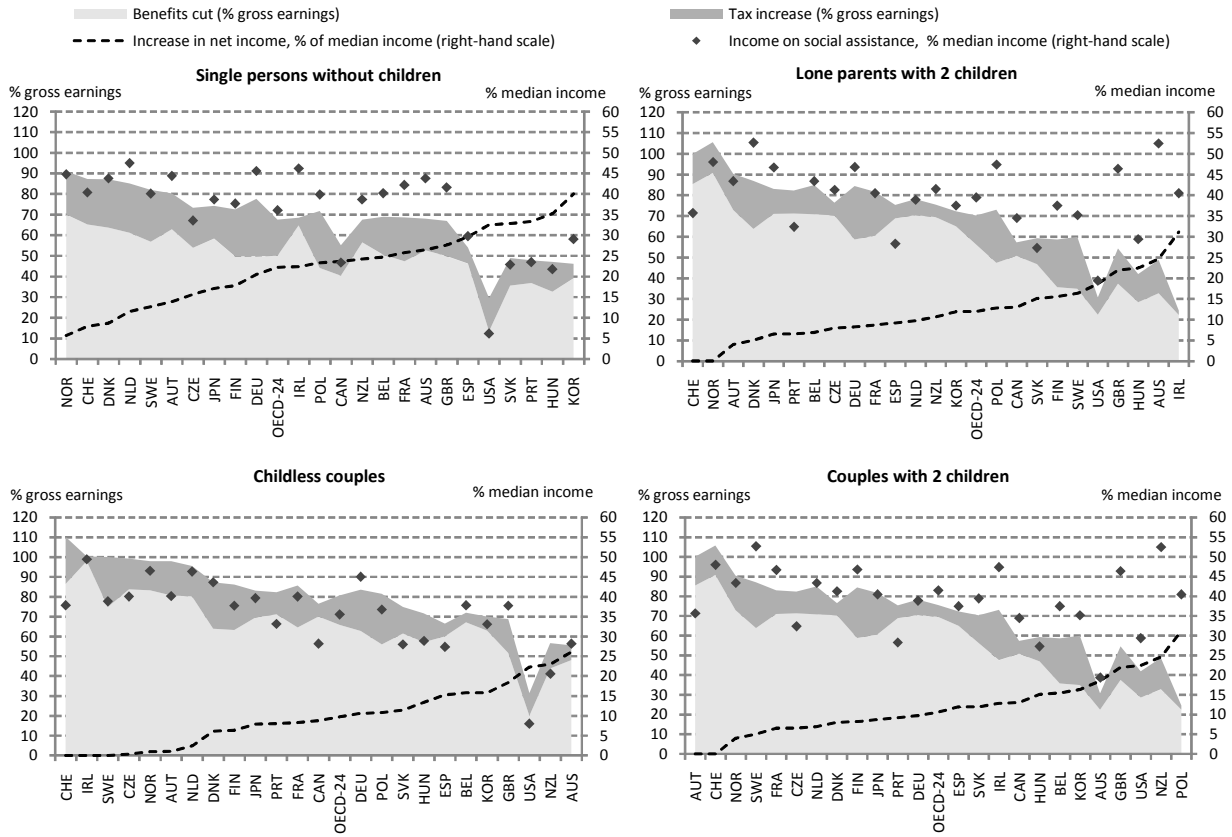
*Source*: OECD tax-benefit models.

Figure 4.15 **Average effective tax rates for households with low earnings potentials, 2005**

Individuals working in a low-paid job, earning 40% of the average wage on an hourly basis

Panel A. Households with one full-time worker[a]

Reference: households on social assistance




Panel B. Households with head working full-time and spouse working half-time[a]

Reference: households with one full-time worker

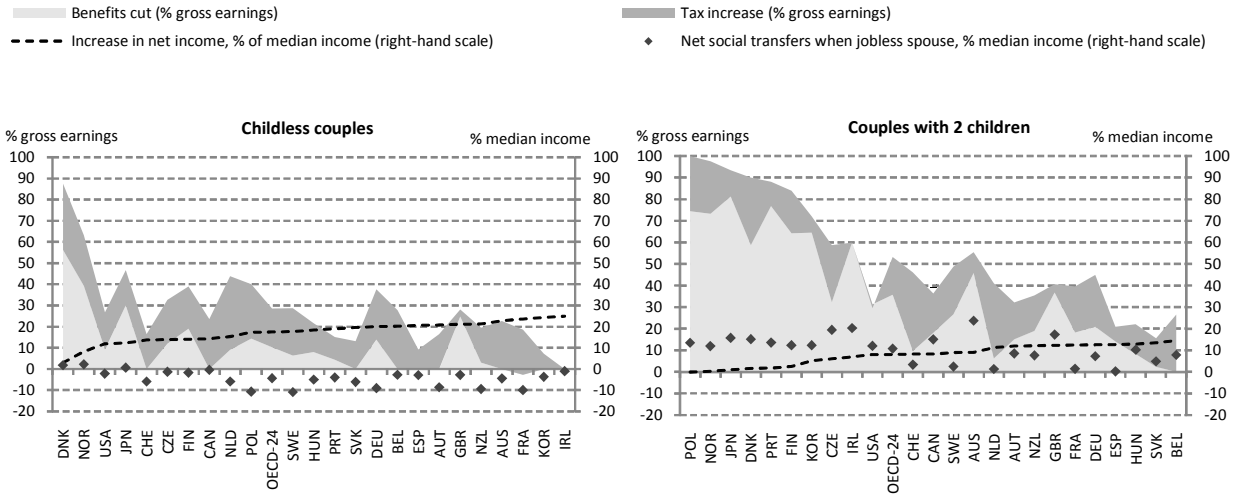
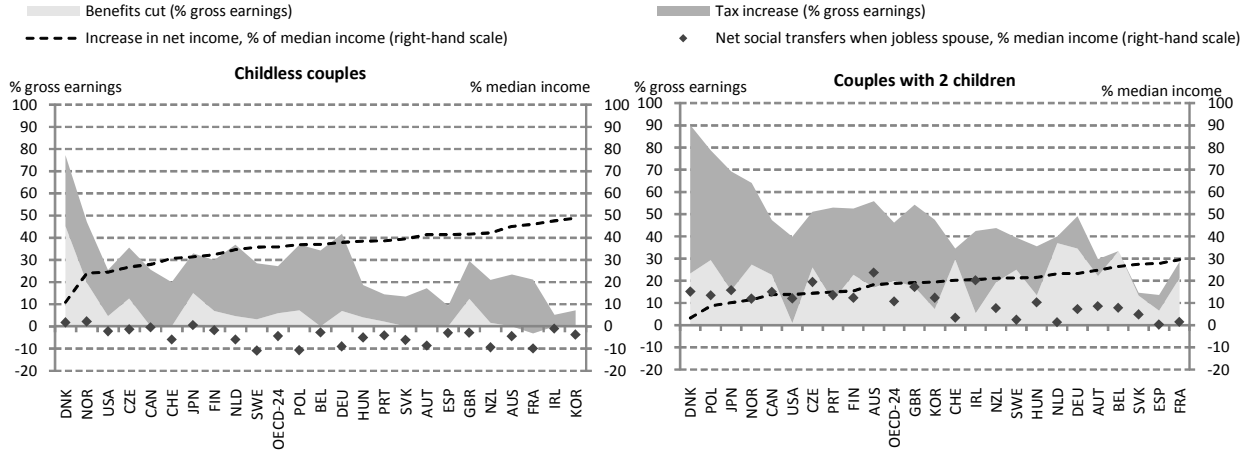


Figure 4.15 **Average effective tax rates for households with low earnings potentials, 2005 (*cont.*)**

Panel C. Households with head and spouse working full-time

Reference: households with one full-time worker




Note:

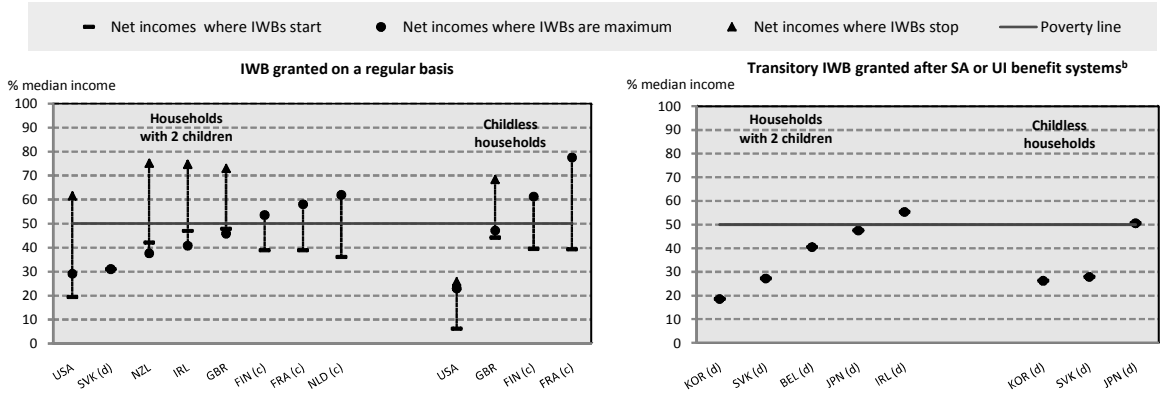
a) Full-time employment corresponds to 40 hours of work per week and per worker. See Box 4.2 for details on the OECD tax-benefit model assumptions.

*Source*: OECD tax-benefit models.

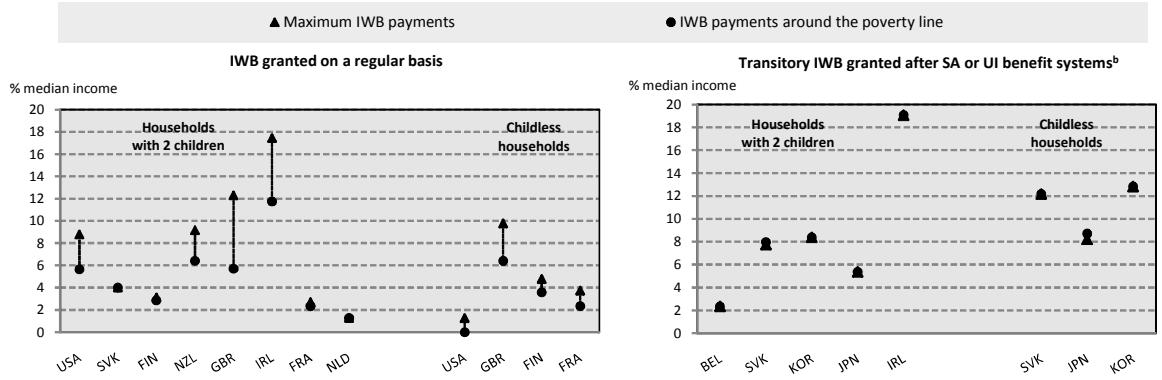
Figure 4.16 **How much do low-paid workers get from in-work benefit schemes?**

Households with at least one worker, earning 40% of AW on an hourly basis, 2005

Panel A. Range of net incomes with in-work benefits, as a percentage of median equivalised income[a]




Panel B. Amounts paid, as a percentage of median equivalised income[e]




Note:

IWB: In-work benefits.

a) Net incomes where IWBs start (stop) refer to the minimum (maximum) level of net incomes where IWBs start (stop) over 2 types of household: single persons and couples. Net incomes where IWBs are maximum refer to the average net incomes where IWBs are maximum over the same 2 types of households.

b) Transitory benefits paid after a move from the unemployment insurance or social assistance systems can also be found in Australia, Canada, France, Netherlands and the United States, but they represent small amounts and/or are granted over a small range of incomes.

c) The phasing-out of in-work benefits ends up after the income level that a family containing only low-wage workers (40% of AW) can reach.

d) Lump-sum: In-work benefits remain constant after the income level shown in the above figure (*i.e.* the phasing-out starts after the maximum income level that a family containg only low-age workers can reach).

e) Maximum amount over 2 types of household, namely single persons and couples. Amount around the poverty line: average over 2 types of household, namely single persons and couples

*Source*: OECD tax-benefit models.

Table 4.1 **Correlation coefficients between employment rates and poverty rates among the working-age population**

| | Aggregate employment rate | | | Employment rates by household type | | | |
|---|---|---|---|---|---|---|---|
| | | Variables purged from… | | | Variables purged from… | | |
| | Basic | …country fixed effects | …country and time fixed effects | Basic | …household fixed effects | … household and country fixed effects | …household, country and time fixed effects |
| Poverty rates (after social transfers) | -0.16 | 0.00 | -0.26* | -0.34*** | -0.16*** | -0.23*** | -0.24*** |
| Nb. of observations (a) | 49 | 49 | 49 | 252 | 252 | 252 | 252 |

Notes:

***, **, * statistically significant at 1%, 5%, 10% levels, respectively.

a) At the aggregate, these coefficients are established for 21 countries (Australia, Belgium, Canada, Czech Republic, Germany, Denmark, Spain, Finland, France, United Kingdom, Greece, Hungary, Italy, Japan, Mexico, Netherlands, Norway, New Zealand, Portugal, Sweden and United States) and 3 years (mid1990s, 2000 and mid-2000s).

At the household level, these correlation coefficients are established for the same countries and years as previously, as well as for 4 types of household: one-adult households with/without children; two-adult households with/without children. For each type of household, the corresponding employment rate is calculated as the number of individuals leaving in households with a head of working-age and at least one worker divided by the number of individuals living in the same type of households (regardless of the household employment situation). For two-adult households, individuals living in households with only one worker are given a weight equal to 0.5 in the numerator.

*Source*: OECD (2008a).

Table 4.2 **Correlation coefficients between employment rates and poverty rates among the working-age population, before and after social transfers**

| | Employment rates | | |
|---|---|---|---|
| | | Variables purged from… | |
| **Poverty rates** | Basic | … hhd and country fixed effects | … hhd, country and time fixed effects |
| Poverty rates before social transfers | -0.59*** | -0.70*** | -0.69*** |
| Poverty rates after social transfers | -0.34*** | -0.23*** | -0.24*** |
| Nb. of observations (a) | 252 | 252 | 252 |

Notes:

***, **, * statistically significant at 1%, 5%, 10% levels, respectively.

a) See Table 3.1.

*Source*: OECD (2008a).

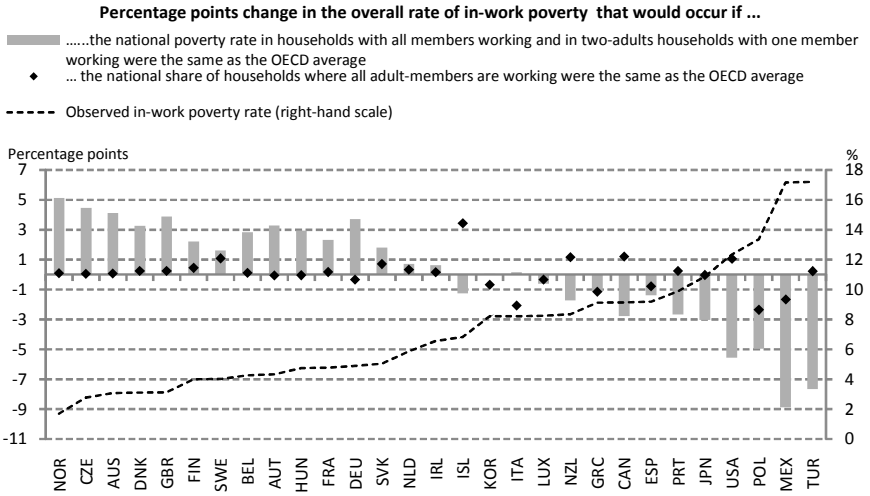
## ANNEX FIGURES AND TABLES

Figure 4.A1 **Underemployment at the extensive margin and in-work poverty rates, mid-2000s**

Panel A. Share of households where all adults have a job among the working poor population

Percentages


Panel B. Cross-country differences in in-work poverty rates and share of one-earner couples in the working-age population[a, b]




Note:

a) Population is split over households with all members working (singles or two-earner couples) and one-earner couples.

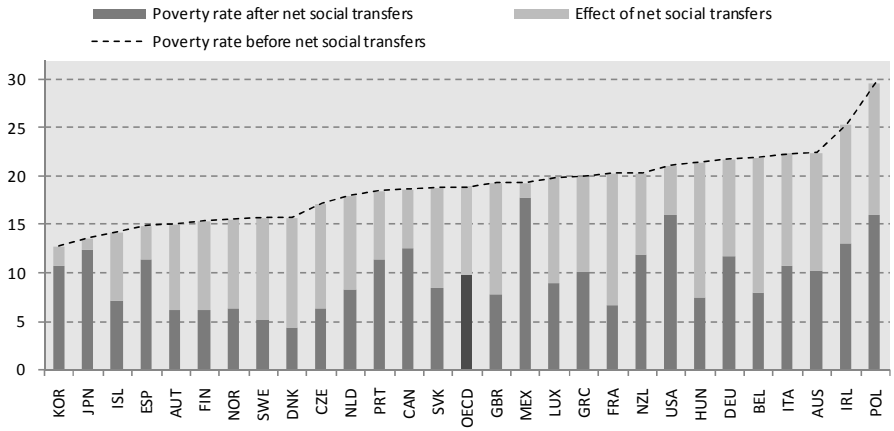
b) Countries are ranked by increasing observed (aggregate) in-work poverty rates.

Reading note: In Sweden, the aggregate in-work poverty rate would be 1.6 percentage points higher than that observed, if the poverty rates for both households with all members working and couples with one member working were the same in this country as those observed on average in the OECD area. Sweden would also exhibit a slightly higher (by 1 percentage point) aggregate rate of poverty, if this country had exactly the same share of households with all members working as that observed on average in the OECD area.

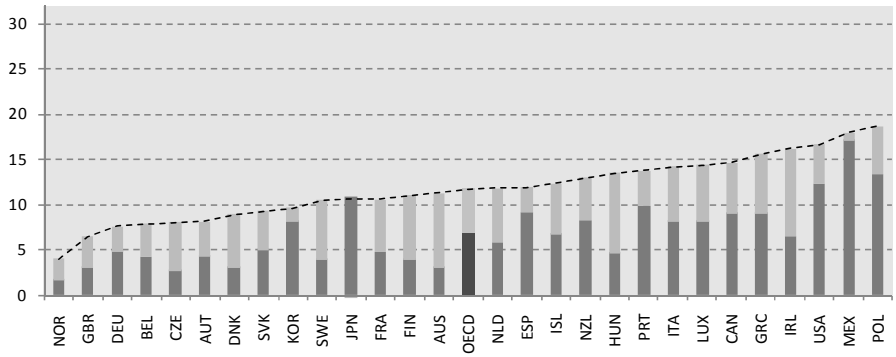
*Source*: OECD (2008a).

Figure 4.A2 **By how much do social transfers reduce poverty?**

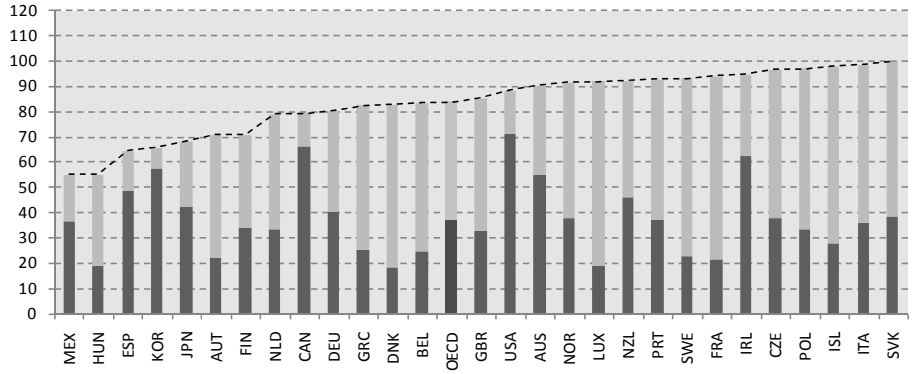
Panel A. Poverty rate among the working-age population[a]




Panel B. Poverty rate among working households[a]




Panel C. Poverty rate among jobless households[a]




Note:

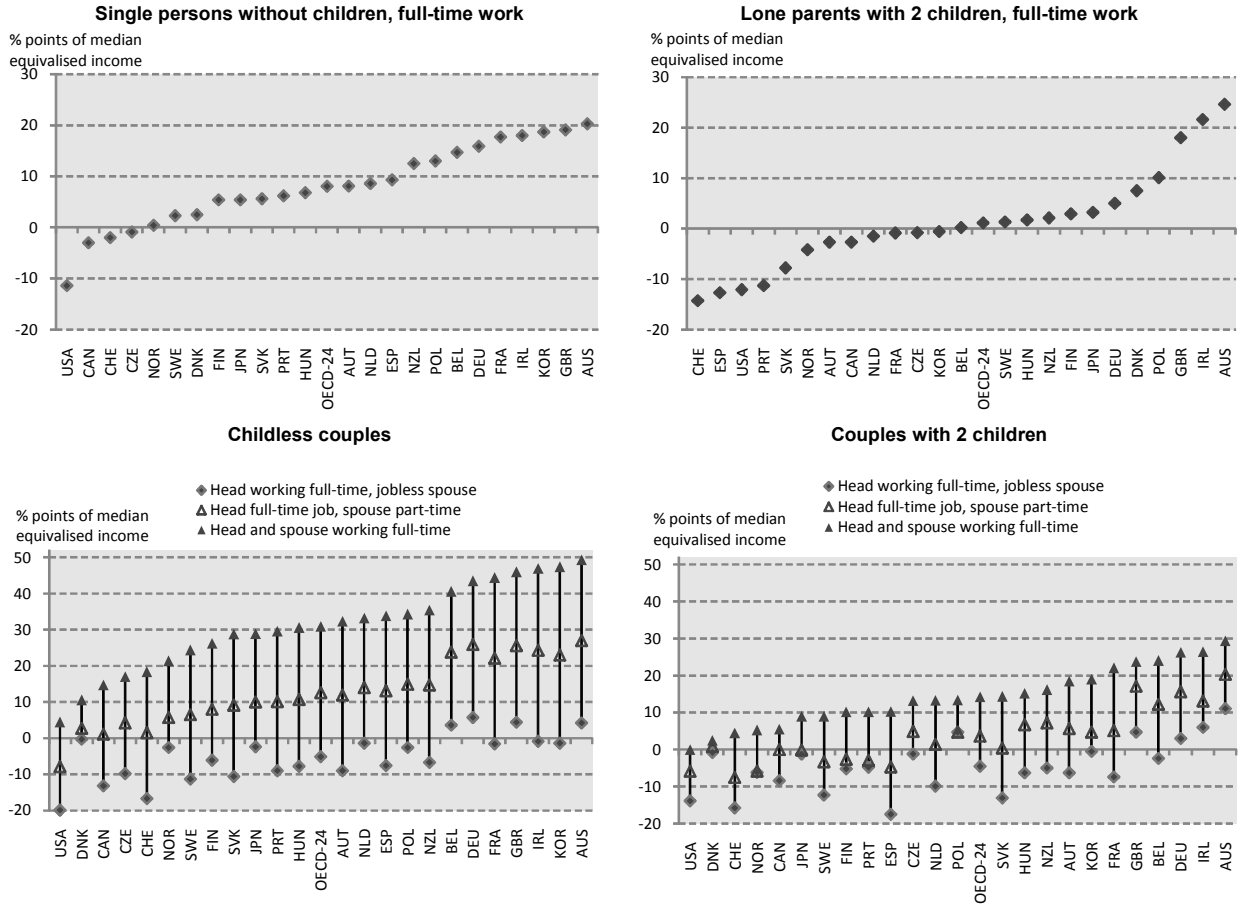
a) Poverty rates before and after transfers are calculated on market-income and disposable income, respectively. In both cases, poverty rates are calculated as the percentage of individuals living in households with income below 50 % of the median income: for all individuals living in all households with a head of working age (Panel A); for individuals living in households with at least one worker (Panel B); for individuals living in households with no workers (Panel C).

*Source*: OECD (2008a).

Figure 4.A3 **Income gains from working full-time as compared to the net income around the poverty threshold[a], 2005**

Difference between net incomes of full-time workers and the poverty threshold

Individuals working in a low-paid job, earning 40% of the average wage on an hourly basis




Note:

a) The poverty line is set to 50% of the median equivalised income, and full-time employment corresponds to 40 hours of work per week and per worker. For couples, the reference household is a household with the head working the number of hours necessary to reach the poverty line, with a jobless spouse.

*Source*: OECD Tax-benefits model.

Table 4.A1. **Low-income thresholds used in the analysis**

2005 values

| | | Currency Unit | In national currency 50% of median | | | |
|---|---|---|---|---|---|---|
| | | | Single without children | Single with two children | Couple without children | Couple with two children |
| Australia | 2004 | AUD | 14 770 | 25 582 | 20 888 | 29 540 |
| Austria | 2004 | EUR | 9 964 | 17 258 | 14 091 | 19 927 |
| Belgium | 2004 | EUR | 9 159 | 15 864 | 12 953 | 18 318 |
| Canada | 2005 | CAD | 15 049 | 26 066 | 21 283 | 30 098 |
| Czech Republic | 2004 | CZK | 76 733 | 132 905 | 108 516 | 153 465 |
| Denmark | 2005 | DKK | 94 376 | 163 463 | 133 467 | 188 751 |
| Finland | 2004 | EUR | 10 060 | 17 425 | 14 227 | 20 121 |
| France | 2004 | EUR | 8 691 | 15 053 | 12 291 | 17 382 |
| Germany | 2004 | EUR | 9 109 | 15 777 | 12 882 | 18 218 |
| Greece | 2004 | EUR | 5 657 | 9 799 | 8 001 | 11 315 |
| Hungary | 2005 | HUF | 544 482 | 943 071 | 770 014 | 1 088 964 |
| Iceland | 2004 | ISK, 000 | 1 045 | 1 810 | 1 478 | 2 090 |
| Ireland | 2005 | EUR | 10 775 | 18 664 | 15 239 | 21 551 |
| Italy | 2004 | EUR | 7 004 | 12 131 | 9 905 | 14 008 |
| Japan | 2003 | JPN, 00 | 14 975 | 25 937 | 21 178 | 29 950 |
| Korea | 2005 | KRW, 000 | 7 756 | 13 434 | 10 969 | 15 512 |
| Luxembourg | 2004 | EUR | 16 171 | 28 010 | 22 870 | 32 343 |
| Mexico | 2004 | MNX | 15 675 | 27 149 | 22 167 | 31 349 |
| Netherlands | 2004 | EUR | 11 484 | 19 891 | 16 241 | 22 968 |
| New Zealand | 2003 | NZD | 13 040 | 22 587 | 18 442 | 26 081 |
| Norway | 2004 | NOK | 118 294 | 204 891 | 167 293 | 236 587 |
| Poland | 2004 | PLN | 6 924 | 11 994 | 9 793 | 13 849 |
| Portugal | 2004 | EUR | 4 197 | 7 270 | 5 936 | 8 394 |
| Slovakia | 2004 | SKK | 67 213 | 116 416 | 95 053 | 134 426 |
| Spain | 2004 | EUR | 6 345 | 10 989 | 8 973 | 12 690 |
| Sweden | 2004 | SEK | 89 832 | 155 594 | 127 042 | 179 665 |
| Switzerland | 2004-05 | CHF | 23 141 | 40 082 | 32 727 | 46 283 |
| Turkey | 2004 | TRY, 000000 | 2 067 | 3 581 | 2 924 | 4 135 |
| United Kingdom | 2005 | GBP | 7 038 | 12 190 | 9 953 | 14 075 |
| United States | 2005 | USD | 13 495 | 23 374 | 19 085 | 26 990 |

*Source*: OECD (2008a).