IZA Institute of Labor Economics

Initiated by Deutsche Post Foundation

DISCUSSION PAPER SERIES

IZA DP No. 10665

Income Support Policies for the Working Poor

Sarah Marchal
Ive Marx
Gerlinde Verbist

MARCH 2017

I Z A Institute of Labor Economics

Initiated by Deutsche Post Foundation

DISCUSSION PAPER SERIES

IZA DP No. 10665

Income Support Policies for the Working Poor

Sarah Marchal
University of Antwerp

Ive Marx
University of Antwerp and IZA

Gerlinde Verbist
University of Antwerp

MARCH 2017

IZA – Institute of Labor Economics

Schaumburg-Lippe-Straße 5–9
53113 Bonn, Germany

Phone: +49-228-3894-0
Email: publications@iza.org

www.iza.org

ABSTRACT

Income Support Policies for the Working Poor

This paper asks what governments in the EU Member States and some US states are doing to support workers on low wages. Using model family simulations, we assess the policy measures currently in place to guarantee an adequate disposable income to working families, taking into account minimum wages, social security contributions, taxes and cash benefits. We show that despite increased efforts over the past decade, disposable incomes of certain types of minimum wage workers still fall well below the EU at-risk-of-poverty thresholds in many countries. Single earners with dependent children are especially at risk of poverty. We discuss the options for making progress.

JEL Classification: I38, J88, H75

Keywords: direct income support, minimum wages, in-work benefits, in-work poverty

Corresponding author:
Ive Marx
Centre for Social Policy
University of Antwerp
St Jacobstraat 2
2000 Antwerpen
Belgium
E-mail: ive.marx@ua.ac.be

1 Introduction

This paper asks what policy makers can do to prevent or reduce in-work poverty. They can act through measures that affect incomes in more or less direct ways, or they can try to affect living standards in more indirect and perhaps more structural ways. This paper will mostly focus on the first type of policies[1]. We focus here on the rich world, notably the EU and the US.

Before we start we need to point out that which policy action, or set of policy actions, is most appropriate cannot be seen as entirely independent from normative notions that underlie the various ways in-work poverty can be construed (see also Lohmann, forthcoming). In-work poverty in Europe, as it is conventionally measured, is to a considerable extent concentrated among low work intensity households, for example dual adult households with only one working adult, or part-time working single persons.

That has important implications. Take for example a two adult household with two dependent children. Only one adult is working. The male breadwinner, in this particular example, has a low-paid job. His partner does not work. Child benefits are modest in the country where they live. The household finds itself living in financial poverty according to some widely used threshold.

Whether, and to what extent, the poverty status of that household is seen as a problem of insufficient breadwinner earnings, or as a problem of partner non-participation in work, or as a problem of insufficient child support makes a fundamental difference as to what type of policy action is to be examined and possibly favored. Some will claim that the problem here is insufficient or low earnings. Not surprisingly, the working poor tend to loom large in debates about minimum wages or 'living wages" (see for instance Horton and Wills, forthcoming). Another section opinion in Europe would brand our example of a traditional breadwinner family with insufficient earnings as a problem of partner under-participation in the labor market. But other cases are less clear-cut. Even if in-work poverty is construed as largely a problem of low household work intensity, the question arises what can be deemed to be a sufficient level of work intensity. It is not self-evident that this is equal to all working-age, work capable adults in the household being in full-time work the whole year round. Societal norms may differ across countries. In countries like the Netherlands, for example, a 4/5th job per adult appears to be closer to the norm of full work intensity. In the Nordic countries, long career interruptions are the norm. Also, household composition may be deemed to matter. It is not self-evident that a lone parent with young children is expected to work full-year, full-time before additional income support is considered legitimate if his or her earnings fall short of the poverty threshold.

Policy is of course never free from normative choices, even if the objective of the policy is not a matter of political debate. In the case of the policies to combat in-work poverty such issues can present themselves in particularly salient ways, as the example above may help to illustrate.

Another issue, which we already briefly mentioned at the start, is how much policy is geared towards achieving immediate poverty relief, for example through work-conditional benefits, possibly at the cost of supply and earnings-mobility disincentives, or whether policy aims for longer term, more

[1] See among other contributions Van Lancker and Horemans (forthcoming) for a discussion of child care as an example of the second type of policies.

structural improvements, for example through training programs that boost earnings, but possibly at the cost of less effective immediate poverty relief. If the resources are not available to pursue both policy courses at the same time a choice has to be made. Again, this choice can only be made as a function of political priorities. In this paper we largely sidestep these normative questions. Rather, our aim is to provide an overview and discussion of the direct income support measures available to workers.

To this end, we first discuss how different countries guarantee an income floor for working households through a minimum wage. We focus on the relatively straightforward cases of a single person and a lone parent family. The minimum wage is not the only determinant of households' living standards; also other income support instruments play an important role in guaranteeing minimal living standards to workers. Such instruments can be found in the form of personal income tax reliefs, social security reductions and different types of social benefits. How these instruments can play a broader role in combating in-work poverty is the topic of section 3. Finally, we conclude.

2 Income floors for working families at the minimum wage

The course of action most commonly associated with preventing in-work poverty is the minimum wage, be it legally determined or set through collective bargaining. In this section we look at the net disposable income of households at a minimum wage, relative to the poverty threshold. Whereas research qualifies the intuition that high minimum wages are an effective tool in combatting in-work poverty, it is conceptually an interesting starting point as it lays a floor under the income one can get while in-work.

Nearly all EU Member States have a national statutory minimum wage (Marx, Marchal, & Nolan, 2013). There are some exceptions, most importantly the Scandinavian countries, Austria and Italy. Yet in 2009, the Austrian social partners included in a national agreement a minimum wage that although not statutory, does cover the large majority of the labor force. Germany has introduced a national minimum wage in 2015. Belgium and Greece have a quasi-statutory minimum wage. In Italy, Denmark, Finland, Norway and Sweden, only sectoral minimum wages exist.

The share of employees that works for a minimum wage differs largely among the EU countries. Ryckx and Kampelmann (2012) use the EU SILC survey data to comparably estimate the share of minimum wage workers in 8 EU Member States in 2007. They find substantial variation, with only 3.8% of the workforce working for a minimum wage in Spain, to 11.5% in Hungary, that they link to the different relative levels of minimum wages. In addition, in some countries, such as Belgium, sectoral agreements lay an entire additional structure of minimum wage protections above the national income floor. Recently, the OECD (2015) repeated this exercise on the European Structure of Earnings survey for 13 EU Member States, finding once again a large variation in the share of minimum wage earners (ranging from 0.2 to 14.2 % of the national labour force). They did not find indications for a link with the relative level of the minimum wage, a finding they attribute to the largely varying strength of collective bargaining in the selected countries. Both studies find that minimum wage earners are generally younger, low-educated and overrepresented among workers with temporary contracts. In addition, Ryckx and Kampelmann (2012) also look at the household composition of minimum wage earners.

Unsurprisingly, they find that minimum wage earners are overrepresented in families with lower household incomes. Also, they are more often part of larger families.

Minimum wage levels are commonly assessed in relation to the average wage (the so-called Kaitz-index). As our preoccupation lies with the adequacy of the social floor, we compare the minimum wage to the EU 60% at-risk-of-poverty threshold. In addition, we focus on the total net disposable income, calculated according to the tax benefit rules applicable at the minimum wage in 2012 for two hypothetical households[2]. The white bars in figure 1 show the gross minimum wage, as a percentage of the at risk of poverty threshold in each country for a single person household (panel A) and a lone parent household with two children (panel B).

Despite its international prevalence, large variation exists in minimum wage levels. Minimum wages generally suffice to protect one single adult against poverty, as defined by the European Union at 60% of the national median equivalent household income. Yet this is not the case in the United States, the Czech Republic, Latvia, Slovakia, Estonia, Lithuania and Bulgaria, although generally, the shortfall is limited. The situation is more dire when a single minimum wage should support more persons, as may be the case in breadwinner households or lone parent families. For a hypothetical lone parent household with two children, the gross minimum wage only sufficed in Greece, and this is under very generous assumptions (most in particular that the parent receives an experience-related top-up to the minimum wage). Generally, a gross minimum wage on its own cannot support a family of three. The shortfall is often quite large.

One might then consider to raise the minimum wage. One often-heard argument against raising minimum wages, or effective wage floors, to combat in-work poverty is that significant reductions in low paid work come at the cost of fewer jobs. Whether or not this is actually a valid argument against raising minimum wages as a way of combating in-work poverty remains open for discussion. The debate about the question of whether minimum wages destroy jobs, or stifle job growth, is as old as the minimum wage itself. A wealth of empirical evidence has been amassed by labor economists (OECD, 2015). The measured effects of minimum wage increases have never been very large, perhaps because actual increases tend to be very cautious and conservative. Research does suggest that the effects may be stronger for particular subgroups. When significant negative employment effects are found, they tend to be among young people. As Martin and Immervoll (2007) state: “On balance, the evidence shows that an appropriately-set minimum wage need not have large negative effects on job prospects, especially if wage floors are properly differentiated (e.g. lower rates for young workers) and

[2] Figure 1 shows the guaranteed minimum income for a hypothetical household (in casu a single and a lone parent with two children). The hypothetical household simulations are based on the assumption that the adult works full-time at the minimum wage (or a proxy of the wage floor), and take account of the applicable tax benefit rules. Please note that in doing so, figure 1 is based on a relatively generous point of departure. Full-time work may not be available or feasible. Moreover, the calculations assume full take-up of benefits and full compliance with minimum wage regulations. For Italy, Denmark and Finland, we proxy the wage floor through the sectoral minimum wage in a low-paid sector, respectively the leather- and fur sector, the retail sector and the cleaning sector. Please note that this proxy of the wage floor disregards gaps in coverage that may arise through reliance upon sectoral minimum wages. Figure 1 refers to 2012, when Germany had not yet introduced a national minimum wage. Other than for the other countries, the data do not show a specific sectoral minimum wage. Rather, the hypothetical household simulations are based on an often-cited minimum wage proposal at the time: an hourly minimum wage of €7.5. Ultimately, the German government introduced a national hourly minimum wage of €8.5 in 2015.

non-wage labor costs are kept in check.” Also, the extent to which relatively high wage floors are compatible with acceptably functioning labour markets will depend on a host of contextual factors such as work force skills levels, sectoral composition of the economy, other institutional and regulatory factors etc. It is clear, for example, that countries with better skilled work forces manage to sustain more compressed wage distributions (OECD, 2015b)

A more pertinent argument against employing minimum wages as a strategy against in-work poverty is that because of the limited overlap between individual low pay and poverty (see Maitre, Nolan and Whelan, forthcoming) any policy aimed at improving the earnings of low-paid individuals will directly benefit only a minority of poor households. This is particularly true in the case of a minimum wage, even one which would be highly effective in increasing the gross earnings of the low-paid without having an adverse impact on employment levels. Studies suggest that even in those cases where the overlap between low pay and household poverty is the greatest, as is the case in the United States, increases in the minimum wage have a relatively limited impact on poverty or income inequality and a substantial spillover to the non-poor (see for example Formby, Bishop, & Kim, 2005). As micro-simulation exercises make clear, also in a European context the isolated poverty-reducing effects of minimum wage increases remain very small (see for example Marx, Vanhille, & Verbist, 2012; Sutherland, 2001), with the impact being slightly more substantial for single people, especially single people with dependent children. Of course, it is also important to consider where any employment effects would occur, but it is far from clear whether the low-paid living in poor households are likely to be more or less vulnerable than those in non-poor households.

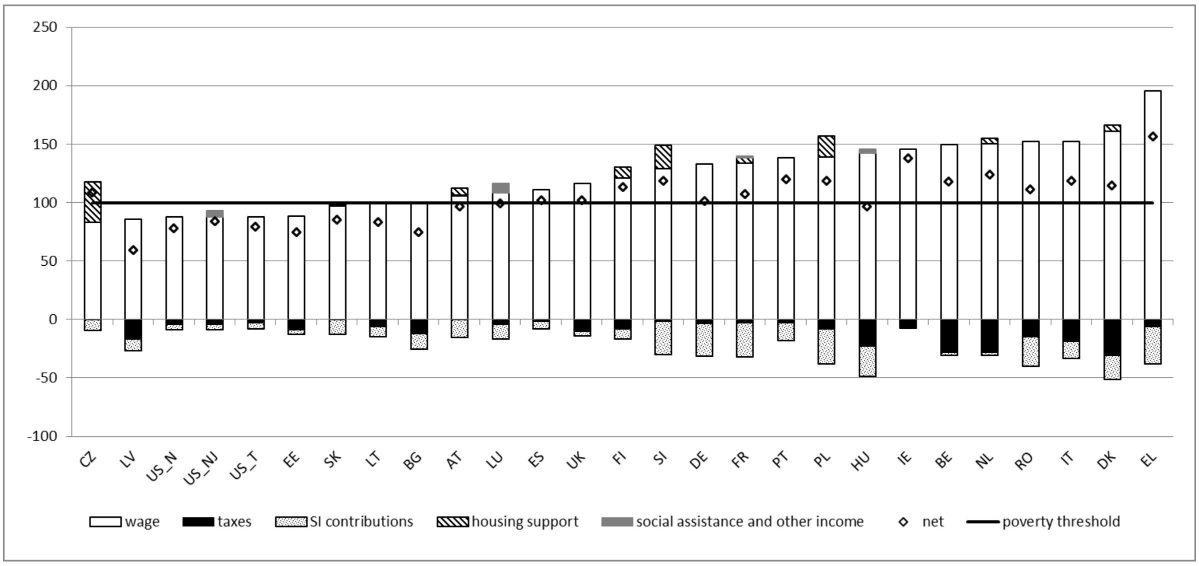
All in all, as an isolated measure, higher minimum wages – within realistically feasible ranges – cannot contribute much towards fighting in-work poverty. But this limited impact on poverty is not, in itself, an argument against the introduction of a minimum wage or against minimum wage increases. For a small subset of low-paid workers adequate minimum wages can make a difference. Minimum wages set in the upper range of the prevailing levels in developed economies are in theory more than adequate to keep single workers out of poverty. Moreover, a minimum wage can, for example, help to contain the budgetary cost and possible wage erosion effects of benefits and tax credits that supplement low earnings.

Figure 1 clearly shows that such measures are indeed relevant for minimum wage families. Governments intervene more directly on the income floor for working families through taxing and supplementing market incomes through benefits. Whereas single person households are in most countries net contributors, even at minimum wage levels, lone parent households generally see their income increased through government intervention.

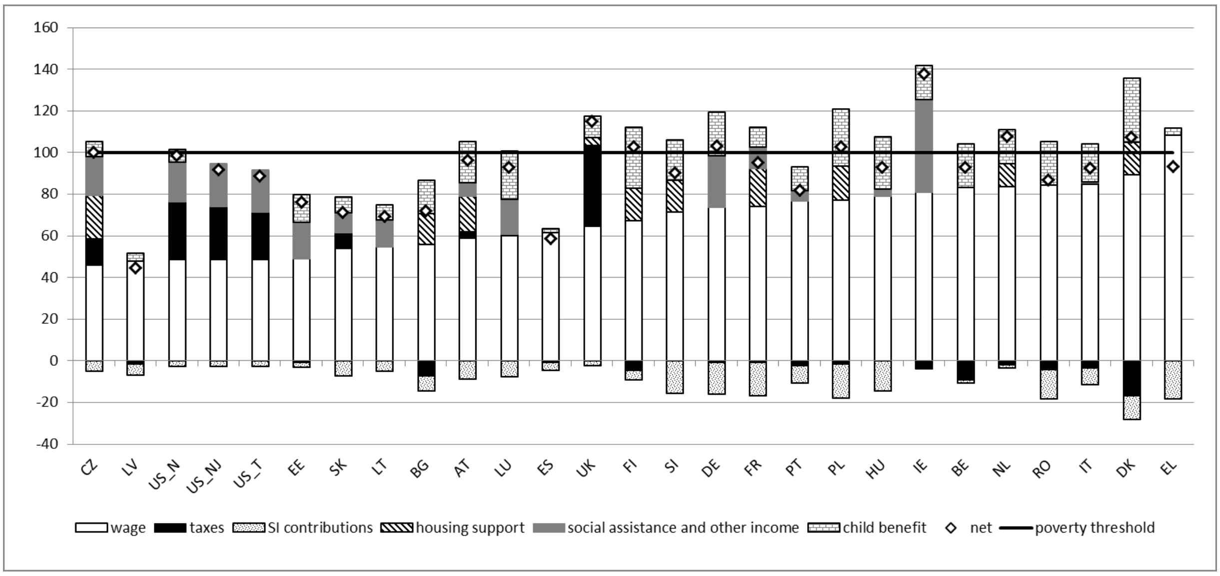
Some income components are more important than others in providing additional support to specific minimum wage families. In line with their founding insurance principle, social insurance rates are in general the same regardless of the household composition or wage level. Indeed, the single household and the lone parent with two children contribute the same percentage of the gross minimum wage in all countries included in Figure 1. Contribution rates vary from a low 4.8% of the earned income in Estonia, to over 21% in France and Poland. In a number of countries, social insurance contributions are however lower for low wage earners. The United Kingdom and Ireland apply lower rates, whereas Belgium and the Netherlands apply a rebate on contributions due to low wage earners, effectively bringing contribution rates under 4% of earned income.

Figure 1. Structure of minimum income protection

Panel A. Single person household, 2012, full-time employment at minimum wage



Panel B. Lone parent household with two children, 2012, full-time employment at minimum wage



Note: countries are ranked by level of the minimum wage

Source: CSB MIPI Version 3/2013 (Van Mechelen, Marchal, Goedemé, Marx, & Cantillon, 2011); Eurostat (2015)

Due to the progressive design of most European tax systems and further allowances or credits for low wage earners, tax liabilities are relatively limited for both family types. The income tax rate for a single household is at most around 20 % in Latvia, Denmark, Belgium and the Netherlands, and still reaches 10 – 15 % in Hungary, Bulgaria, Romania, Italy and Estonia. In most countries however, income tax rates, even for singles, remain well below 10% of the gross minimum wage. If income tax rates at minimum wage are low for singles, they become quasi-negligible (or positive, see below) when there are dependent children in the household, thanks to tax allowances and credits for children. Bar in

Denmark, Belgium and Bulgaria[3], all countries had in 2012 tax rates below 10% for a lone parent with two children.

Which policy instruments are then used to increase the net income of lone parent households (see panel B of Figure 1)? The US and the UK favor large income tax credits[4]. Similar policy interventions are rare: the Czech Republic and Slovakia are the only other EU Member States with substantial tax credits. Child benefits on the other hand are a very common income component, as are housing and heating allowances. Finally, in a substantial number of countries working lone parent households are eligible for means-tested social assistance benefits. This social assistance top-up ensures that in-work income exceeds the out-of-work social assistance benefit, through earnings disregards in the calculation of the top-up. The generosity of social assistance benefits and of the related earnings disregards varies largely across the European Member States.

Clearly even with these additional direct income support measures, the net disposable income at minimum wage is inadequate for the lone parent type case. This is the case, even though the relative importance of these income components has increased over the past decade (Marchal & Marx, forthcoming). The upper graphs in Figure 2 show the percentage point changes (relative to the national at-risk-of-poverty threshold) in gross minimum wage and net disposable income for a single and a lone parent with two children from 2001 to 2012, ranked by the difference in trends between both indicators. In quite a few countries, relative trends in net disposable income at minimum wage diverged substantially from those in gross minimum wages. For instance, in Hungary, Estonia and the Czech Republic trends in net disposable income lagged behind trends in gross minimum wage. More often however, net disposable income increased more (or decreased less) than gross minimum wages. This was especially the case for lone parents with children: in the US states, but also in Luxembourg, Lithuania, Poland, Belgium, Portugal and France, governments turned to direct income support measures to boost the effects of raising minimum wages, or to mitigate the effects of its erosion.

In the bottom graphs of Figure 2, we show the variation in the income support measures taken. There has not been one preferred strategy. The gross minimum wage erosion (relative to the poverty threshold) was mitigated through further tax and/or social insurance contribution decreases in Belgium, Italy and Lithuania; and through a combination of both tax measures and benefits in the Czech Republic. In Slovenia on the other hand the effects of the increased gross minimum wage on net disposable income were boosted through the social assistance reform that made single minimum wage earners eligible for a housing benefit. For lone parents with children, increases in net disposable income over and above those in gross minimum wages are often due to a combination of tax decreases and benefit increases. For instance, in Lithuania, tax liabilities decreased substantially for a lone parent with two children from 2001 to 2012. In addition, this family type benefited from the introduction of a (first universal, but later means-tested) child benefit.

The combination of these different measures, minimum wages, taxes, social insurance contributions and benefits, guarantee a minimum income floor to working families. The different instruments impact on each other. In this regard, it is important to highlight the policy reform implemented in Hungary,

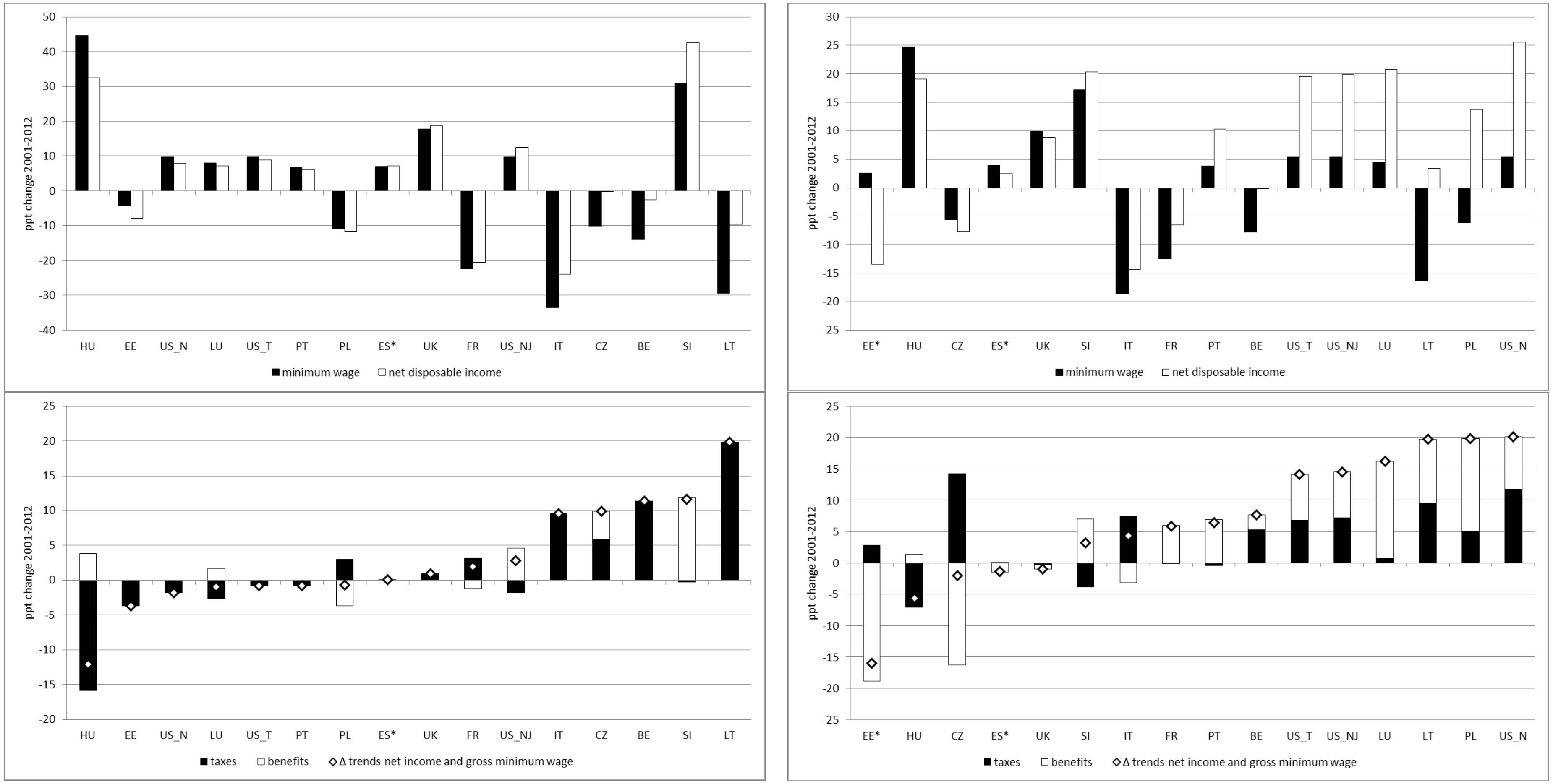
[3] Please note that Belgium has focused on social insurance contributions to lower tax liabilities of low wage workers. Denmark in general focuses on benefits and services. Bulgaria has a flat tax.
[4] Note that the simulations refer to January 2012. Since, the UK is in the process of homogenizing out-of-work benefits and tax credits into the universal credit.

where the minimum wage was increased substantially in order to compensate for the abolition of most tax allowances and rebates.

Figure 2. Percentage point changes to the net income package and income components of a one-earner family, employed at minimum wage, 2001-2012, relative to the EU at-risk-of-poverty threshold

Panel A. Single person household

Panel B. Lone parent with 2 children



* EE and ES: 2001-2009. Taxes reflect the combined change in income tax and social insurance contributions liability, as a percentage of the EU at-risk-of-poverty threshold.

Source: CSB MIPI Version 3/2013 (Van Mechelen et al., 2011), Eurostat (2015)

3 Tax-benefit instruments to combat in-work poverty

So far, we have identified – besides minimum wages – tax liabilities, social insurance contributions and other benefits as important elements of the income floor for working families, especially when there are children present. In this section, we look more broadly into how the tax-benefit system can provide important levers in the fight against in-work poverty. Such instruments can be found in the form of personal income tax reliefs, social security reductions and different types of social benefits. The classification of an instrument is not always clear-cut, as e.g. in-work benefits can be labelled as being part of the tax system or as a social benefit; also the distinction between taxes and social security contributions is not that strict any more (e.g. the 'Contribution Sociale Généralisée' in France). While the minimum wage increases that were discussed in the previous section are targeted at the working person itself, these measures can have a wider scope and can be aimed at supporting the entire household. There are, however, different degrees to which the household dimension is incorporated in the instrument. Social security contributions typically refer to the individual, while tax measures and in-work benefits, even though their main focus is on the individual earner, may include aspects that refer to the wider household context (e.g. by making the income threshold family dependent). Moreover, in the context of in-work poverty it is not only necessary to look at the so-called making-work-pay policies, but also more general measures (like child benefits) need to be considered, given the multifaceted perspective on in-work poverty.

3.1 In-work benefits and tax credits

Despite the introduction of tax rebates and allowances for low-wage earners in previous years, average tax rates might still leave some scope for improving the income position of low-wage households through cuts in personal income taxes and (more importantly) employee social contributions. In line with the CSB MIPI-based calculations shown in section 2, OECD calculations for 2013 (OECD, 2015) show that the combined burden of employee social contributions and income taxes on minimum wages still amounts to over 10% of the gross minimum wage in the large majority of countries. It is above 20% for singles in France, Slovenia, Germany, Poland, Latvia and Hungary, and around 20% in Belgium and the Netherlands. Based on CSB MIPI, we know that also Romania and Bulgaria have total tax rates over 20 %, mainly due to substantial social insurance contributions (of 17 and 13%). In contrast, the total tax rate for singles earning a minimum wage is only 4.9% in Ireland and 6.4% in Spain. Many countries have effectively introduced reductions of employees' social contributions on low wages, thus increasing the income progressivity of social contributions and taxes (Immervoll, 2007; OECD, 2011). The prime objective here, however, has in general not been to alleviate in-work poverty but to increase work incentives, particularly the net pay-off to making the transition from dependence on a social assistance or unemployment benefit to a low-paid job.

Increasingly countries have invested in in-work tax benefits and tax credits, with the most well-known examples being the measures taken in the United States (the Earned Income Tax Credit, EITC) and the United Kingdom (the Working Tax Credit). These were the two first countries to implement such a making-work-pay policy, and also the ones that invest most budgetary effort into it. Over the past decades, also various European countries have experimented with this type of policies. In-work benefits can be defined as "permanent work-contingent tax credits, tax allowances or equivalent work-contingent benefit schemes designed with the dual purpose of alleviating in-work poverty and increasing work incentives for low-income workers" (OECD, 2011). They are attractive as they aim to enhance work-incentives for disadvantaged groups, as well as to provide extra income to support their living standards.

Most evaluation studies have focused on the *employment* effects of these in-work benefits and find positive effects on employment rates, even though total employment effects are in general rather small (Immervoll & Pearson, 2009). For both the EITC (e.g. Chetty, Friedman, & Saez, 2013; Eissa & Hoynes, 2006; Meyer & Rosenbaum, 2002) and the Working Family Tax Credit (e.g. Blundell, Duncan, McCrae, & Costas, 2000; Blundell & Shephard, 2012) positive employment participation effects have been found, i.e. more people take on a job due to these benefits. The evidence on hours worked, however, is more mixed; it is indeed possible that in-work benefits may reduce the number of hours worked, as one might decide to work fewer hours in order to qualify for the benefit (OECD, 2011; Saez, 2002).

Mixed evidence is also found regarding the impact on *in-work poverty*. The design of the in-work benefit plays a big role, as well as its interaction with the income distribution. There are indications that the poverty impact is largest in countries with dispersed income distributions, as is the case in the USA and the UK. Far less research has been done on more condensed income distributions. Simulations by Bargain and Orsini (2007) for Germany, France and Finland, by Figari (2010) for four southern European countries (Italy, Spain, Portugal and Greece) and by Marx et al. (2012) for Belgium illustrate that it might not be so evident to apply EITC type systems in other settings.

About half of the OECD countries use one or more permanent in-work benefits, which can be granted in the form of a benefit, a tax reduction (such as a tax credit) or a social insurance contribution reduction (for an overview, see e.g. OECD, 2011). These benefits differ from one another in many dimensions (see e.g. Immervoll & Pearson, 2009; Kenworthy, 2015). In a recent study on the impact of the design characteristics of in-work benefits on employment and poverty, the design characteristics are grouped into the following different categories (Vandelannoote & Verbist, 2016):

1) unit of assessment (individual or household);.
2) income-related characteristics: i.e. the conditionality on income, the presence of a phase-in and phase-out range;
3) employment related characteristics (e.g. conditionality on hours of work);
4) non-employment related characteristics (e.g. presence of children).

Previous studies have indicated the importance of having either the individual or the household as unit of assessment. An individual-based system is more appropriate to improve work incentives, while a household based system has a greater potential for reducing poverty. With a household based system, account is taken of the income of the entire household, which allows for a better targeting of poor households; with an individual system also small earners in a non-poor household can benefit more easily, thus reducing the scope for poverty reduction. The simulation of a set of revenue-neutral scenarios of different types of in-work benefits in Belgium shows that an income targeted benefit reduces poverty (as more of the budget is going towards lower incomes as compared to e.g. a Swedish-style lump sum tax credit) (see Vandelannoote and Verbist, 2016). The stricter the income threshold is set, the stronger the impact on poverty reduction. According to this study the impact of a tapering-out and a tapering-in phase on poverty is rather limited. Setting an income threshold may have a negative impact on hours worked; individuals may not expand their working hours as they might lose their in-work benefit. A way to overcome this problem is to use hourly wages as the basis for awarding the in-work benefit. Vandelannoote and Verbist (2016) show that using hourly wages as a threshold is indeed an interesting route not only for maintaining work incentives but also for reducing poverty.

Some countries also use hours worked as an eligibility criterion for granting an in-work benefit: e.g. one is only eligible for the UK Working Tax Credit if one works at least 16 hours per week. Such a measure provides ambiguous work incentives: it stimulates individuals to work more hours, but it may also deter some individuals from working at all (those who want to work less than the specified hours' threshold).

Non-employment characteristics are often also part of the design of in-work benefits. Especially EITC amounts are contingent on the presence of children: a household with one child can receive a benefit of over $3,000, while for a childless household the maximum is less than one fifth of this amount (Kenworthy, 2015). Thus, the impact of EITC is much larger for families with children than childless ones. In this sense, in-work benefits can also be seen as part of family policies aimed at reducing child poverty.

There are potential downsides to subsidizing low paid work. While EITC is intended to encourage work, EITC-induced increases in labour supply may drive wages down, shifting the intended transfer toward employers. Rothstein (2010) simulates the economic incidence of the EITC under a range of supply and demand elasticities and finds that in all scenarios a substantial portion of the intended transfer to low income single mothers is captured by employers through reduced wages. The transfer to employers is borne in part by low skill workers who are not themselves eligible for the EITC. There is some empirical evidence that corroborates the potential wage erosion effect of EITC (Chetty et al., 2013; Leigh, 2010).

Finally, whether EITC type schemes can work everywhere is not self-evident. The socio-demographic make-up of the US differs from that in most European countries; there are more single adult (and parent) households but also more multi-earner households. The dispersion in earnings is also much more compressed in most European countries, where, in addition, benefits are generally higher relative to wages (including minimum wages) and less subject to means-testing if they derive from social insurance. This also implies that benefit entitlements of household members are less interdependent, possibly weakening the potential impact on labour supply. Many countries have individual taxation, and the trend is away from joint taxation of couples.

Indeed, in order to be effective as an anti-poverty device and at the same time affordable within reasonable limits, such measures need to be strongly targeted. However, strong targeting at households with low earnings is bound to create mobility traps, which can only be avoided if taper-off rates are sufficiently flat. That comes at a very considerable cost if the lower end of the household earnings distribution is densely populated, as is the case in many European countries. This cost can only be avoided by making the amount of the tax credit itself smaller, but in that case the anti-poverty effect is reduced.

3.2 Child benefits and tax credits

Child poverty is an important but often neglected dimension of in-work poverty. According to Eurostat the in-work at-risk-of-poverty rate of single persons with dependent children in the EU-27 is 20.2%, while it is 10% for households with two or more adults with children (for 2013; indicator ilc_iw02). These numbers illustrate that a job in itself is not enough to protect against (child) poverty, and that child support is also part of the story to combat in-work poverty. A possible way to provide child support is to integrate child elements in the in-work benefits, as is for instance the case in the United States and Ireland; this can be done by either including the presence of children in the eligibility criteria (as is for instance the case in the Netherlands) or by having different levels depending on the number of children (as is the case with the EITC) or the household type (e.g. lone parents receive more in the UK Working Tax Credit than other family types). Such child-related eligibility conditions are especially common in countries where in-work benefits play a strong redistributive role (Immervoll and Pearson, 2009). But given the still substantial share of in-work poverty of households with children, this may not be enough and it is important to consider also measures that aim to combat child poverty in a direct way.

Countries deliver cash income support to families with children in two forms, notably child benefits and tax advantages linked to the presence of children in the household. As shown by many studies, these benefits are very relevant when it comes to reducing child poverty (Bradshaw, 2010; Van Lancker & Van Mechelen, 2015). Their poverty reduction effectiveness depends on the budgetary size of the measures, as well as on the design (see e.g. Salanauskaite & Verbist, 2013). The design of the child benefits refers to the way the available budget is distributed over the eligible population, and traditionally a distinction is made between universal and selective systems. A universal system covers all families with children, irrespective of need or income while a selective system restricts benefit eligibility to a specific category, for instance to low-income families or single mother households (Van Lancker & Van Mechelen, 2015). Corak, Lietz, and Sutherland (2005) show that the best performing countries in terms of poverty reduction tend to have systems of universal child benefits and tax concessions that are not particularly strongly targeted at low-income children (see also Marx et al., 2016). Less strongly targeted child benefits can have an immediate impact on poverty among those at high risk (i.e. ‘child-rich’ households) without adversely affecting work incentives between workers and non-workers, although an income effect may have a dampening effect on labor supply. For such benefits to be effective across the board as an anti-poverty device they need to be high enough, which inevitably comes at a significant budgetary cost. This can be remedied to some extent by targeting resources within universal systems proportionally more at the poorest. Together with policies that facilitate and support dual earnership, particularly the employment of the caring partner in the household, such universal benefits with targeted components are bound to constitute a key component of any effective policy package.

4 Conclusion

In this paper we discussed policy measures currently in place in the EU Member States and the US to guarantee adequate incomes to working families. How to move forward?

Minimum wages feature prominently in any debate about in-work poverty. The connection is almost made immediately in the public mind. The issue loomed for example large in German debates before and after the introduction of a minimum wage there. Minimum wages have long been at the heart of public policy debate in the United States, and this is again the case. The UK government has pledged substantial increases in the 'Living Wage' to help working families struggling to make ends meet.

Yet boosting minimum wages to the upper prevailing ranges (relative to average earnings) would not be sufficient to eradicate in-work poverty in any country, even without any negative employment effects. Essentially that is because minimum wages have become inherently constrained in providing minimum income protection to sole breadwinner households in countries where relative poverty thresholds are strongly determined by dual earner living standards.

This having been said, minimum wages still constitute an important foundation of minimum income protection for workers, and, given their role as a benchmark level, not only for those effectively working for the minimum wage. Minimum wages constitute an important foundation of minimum income protection for workers.

In an encompassing anti-poverty strategy, minimum wages can play a crucial role in preventing or at least reducing the possible wage erosion effects of effective low-pay subsidies, for example in the form of tax credits. This points to the importance of instituting minimum wages at a decent level and making sure that these keep pace with average wage growth to the extent possible. But we have to realize that there are limits to what minimum wages can do to prevent in-work poverty.

As we have seen, rather than pushing for higher minimum wages, many governments have undertaken measures to increase the net incomes of workers paid at or around the minimum wage. Minimum wage workers have generally seen their taxes fall over the past decade. In most countries, they pay very low or no taxes, especially when there are children present in the household. In a small number of countries have there been declines in social security contributions. There remains some scope for increasing net disposable incomes via this route. But even with hypothetical zero taxation minimum wage earners would in most countries not have an income sufficient to reach the poverty threshold. Similarly, in several countries supportive benefits, such as social assistance top-ups or in-work benefits, were increased. Yet despite all of these effort, income floors for working households fail to reach the national at-risk-of-poverty threshold in many countries.

We discussed the broader options and pitfalls of these measures as policy levers in the fight against in-work poverty more generally. Our literature review clearly indicates that delicate trade-offs are in play between employment incentives and fighting in-work poverty. Here, the normative considerations that we touched upon in the introduction step back in. Indeed, when it comes to effectively alleviating in-work poverty through income supplements for households mainly reliant on earnings, be it in the form of child benefits, negative income taxes or other equivalent schemes, the reality is that cheap solutions are unlikely to exist, especially if one is also concerned about work and mobility incentives. It is also unlikely that optimal one-size-fits-all solutions exist. The socio-demographic composition of the population and particularly of the working poor matters. Child benefits, for example, will obviously have less of an effect when single person households are affected by in-work poverty, or when this is the case for multi-generation households. The distribution of wages and working hours, across the population and within households, matters greatly to the potential effectiveness and cost of negative income tax or equivalent schemes. Other elements of institutional and policy context are likely to be relevant. That implies that the optimal policy package needs to be tailored to the context – and policy preferences - at hand.

5 References

Bargain, O., & Orsini, K. (2007). Beans for breakfast? How exportable is the British workfare model? In O. Bargain (Ed.), *Microsimulation in action: policy analysis in Europe using EUROMOD* (pp. 165-198). Oxford: Elsevier.

Blundell, R., Duncan, A., McCrae, J., & Costas, M. (2000). The labour market impact of the working families' tax credit. *Fiscal Studies*, 21(1), 75-104.

Blundell, R., & Shephard, A. (2012). Employment, Hours of Work and the Optimal Taxation of Low-Income Families. *The Review of Economic Studies*, 79(2), 481-510. doi:10.1093/restud/rdr034

Bradshaw, J. (2010). An international perspective on child benefit packages. In S. B. Kamerman, S. Phipps, & S. Ben-Arieh (Eds.), *From child welfare to child well-being: an international perspective on knowledge in the service of policy making* (pp. 293-307). Dordrecht, Heidelberg, London, New York: Springer.

Chetty, R., Friedman, J. N., & Saez, E. (2013). Using Differences in Knowledge across Neighborhoods to Uncover the Impacts of the EITC on Earnings. *American Economic Review*, 103(7), 2683-2721.doi: 10.1257/aer.103.7.2683

Corak, M., Lietz, C., & Sutherland, H. (2005). *The impact of tax and transfer systems on children in the European Union* (IZA Discussion Paper 1589). Bonn: IZA.

Currie, J., & Gahvari, F. (2008). Transfers in Cash and In-Kind: Theory Meets the Data. J*ournal of Economic Literature*, 46(2), 333-383. doi: 10.1257/jel.46.2.333

Eissa, N., & Hoynes, H. W. (2006). Behavioral responses to taxes: lessons from the EITC and labor supply. *Tax Policy and the Economy*, 20, 73-110.

Esping-Andersen, G. (2008). Childhood investments and skill formation. *International Tax and Public Finance*, 15(1), 19-44.

Esping-Andersen, G., Garfinkel, I., Han, W.-J., Magnuson, K., Wagner, S., & Waldfogel, J. (2012). Child care and school performance in Denmark and the United States. *Children and Youth Services Review*, 34(3), 576-589.

European Commission. (2009). *The provision of child care services - a comparative review of 30 European countries.* Luxembourg: European Commission.

Eurostat. (2015). *Statistics by theme*. Retrieved May 2015 http://epp.eurostat.ec.europa.eu/portal/page/portal/statistics/themes

Figari, F. (2010). Can in-work benefits improve social inclusion in the southern European countries? *Journal of European Social Policy*, 20(4), 301-315. doi:10.1177/0958928710374375

Formby, J., Bishop, J., & Kim, H. (2005). *Minimum wages and poverty: an evaluation of alternatives*. Amsterdam: Elsevier.

Horton, A. & Wills, J. (forthcoming) Impacts of the living wage on in-work poverty. In Lohmann, H. and Marx, I. (Eds). *Edward Elgar Handbook of Research on In-Work Poverty*. Cheltenham: Edward Elgar.

Immervoll, H. (2007). *Minimum wages, minimum labour costs and the tax treatment of low-wage employment* (Discussion Paper no. 2555). Bonn: IZA.

Immervoll, H., & Pearson, M. (2009). *A Good Time for Making Work Pay? Taking Stock of In-Work Benefits and Related Measures across the OECD* (OECD Social, Employment and Migration Working Papers No. 81). Paris: OECD Publishing.

Kenworthy, L. (2015). *Do Employment-Conditional Earnings Subsidies Work?* (Improve Working paper 15/10). Antwerp: Herman Deleeck Centre for Social Policy.

Leigh, A. (2010). *Who benefits from the earned income tax credit? Incidence among recipients, coworkers and firms* (IZA Discussion paper 4960). Bonn: IZA

Lohmann, H. (forthcoming). The concept and measurement of in-work poverty. In Lohmann, H. and Marx, I. (Eds). *Edward Elgar Handbook of Research on In-Work Poverty*. Cheltenham: Edward Elgar.

Maitre, B., Nolan, B. & Whelan, C. (forthcoming). Low pay, in-work poverty and economic vulnerability. In Lohmann, H. and Marx, I. (Eds). *Edward Elgar Handbook of Research on In-Work Poverty.* Cheltenham: Edward Elgar.

Marchal, S., & Marx, I. (forthcoming). Stemming the tide: What have EU countries and the US done to support low-wage workers in an era of downward wage pressures? *Journal of European Social Policy.*

Martin, J. P., & Immervoll, H. (2007). The minimum wage: making it pay. *OECD Observer*, 261.

Marx, I., Marchal, S., & Nolan, B. (2013). Mind the gap: net incomes of minimum wage workers in the EU and the US. In I. Marx & K. Nelson (Eds.), *Minimum income protection in flux* (pp. 54-80). Houndmills: Palgrave.

Marx, I., Vanhille, J., & Verbist, G. (2012). Combating in-work poverty in continental Europe: the potential impact of higher minimum wages and targeted tax relief. *Journal of Social Policy*, 41(1), 19-41. doi: 10.1017/s0047279411000341

Marx, I, Salanauskaite, L. and G. Verbist (2016). For the poor, but not only the poor: on the optimal design of redistributive policy. *Social Forces*, 95 (1), 1-24.

Meyer, B. D., & Rosenbaum, D. T. (2002). Making single mothers work: recent tax and welfare policy and its effects. In B. D. Meyer & D. Holtz-Eakin (Eds.), *Making work pay* (pp. 69-115). New York: Russel Sage Foundation.

OECD. (2011). *Taxation and employment*. Paris: OECD Publishing.

OECD. (2015). *Minimum wages after the crisis: Making them pay*. Retrieved from www.oecd.org/social/Focus-on-Minimum-Wages-after-the-crisis-2015.pdf

OECD (2015), Skills and wage inequality In *OECD Employment Outlook*. Paris: OECD Publishing

Rothstein, J. (2010). Is the EITC as good as an NIT? Conditional cash transfers and tax incidence. *American Economic Journal: Economic Policy*, 2(1), 177-208.

Ryckx, F., & Kampelmann, S. (2012). *Who earns minimum wages in Europe? New evidence based on household surveys* (ETUI Working Paper N°124). Brussels: European Trade Union Institute.

Saez, E. (2002). Optimal Income Transfer Programs: Intensive versus Extensive Labor Supply Responses. *The Quarterly Journal of Economics*, 117(3), 1039-1073. doi:10.1162/003355302760193959

Salanauskaite, L., & Verbist, G. (2013). Is the neighbour's grass greener? Comparing family support in Lithuania and four other new member states. *Journal of European Social Policy*, 23(3), 315-331. doi:http://dx.doi.org/doi:10.1177/0958928713480066

Sutherland, H. (2001). *The national minimum wage and in-work poverty* (DAE Working Papers MU 0102). Cambridge: University of Cambridge

Van Lancker, W. (2013). Putting the child-centred investment strategy to the test. *European Journal of Social Security*, 15(1), 4-27.

Van Lancker, W. and Horemans, J. (forthcoming). Childcare policies and in-work poverty. In Lohmann, H. and Marx, I. (Eds). *Edward Elgar Handbook of Research on In-Work Poverty*. Cheltenham: Edward Elgar.

Van Lancker, W., & Van Mechelen, N. (2015). Universalism under siege? Exploring the association between targeting, child benefits and child poverty across 26 countries. *Social Science Research*, 50, 60-75. doi:http://dx.doi.org/10.1016/j.ssresearch.2014.11.012

Van Mechelen, N., Marchal, S., Goedemé, T., Marx, I., & Cantillon, B. (2011). T*he CSB-Minimum Income Protection Indicators dataset (CSB-MIPI)* (CSB WP 11/05). Antwerp: Herman Deleeck Centre for Social Policy

Vandelannoote, D., & Verbist, G. (2016). *The design of in-work benefits: how to boost employment and combat poverty in Belgium* (Improve Discussion Paper 16/15). Antwerp: Herman Deleeck Centre for Social Policy