Section Thématique 38: changements dans la gouvernance des politiques sociales et dynamiques du pacte démocratique en Europe

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The transformative power of fiscal welfare

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Introduction

Since the 1990s, welfare state reform has been at the core of much of the welfare state research. From an analysis of reform pressures, to an understanding of welfare state resilience, to a focus on reform trajectories, the literature has highlighted the role of politics, of institutions and of ideas in understanding processes and trajectories of reform. This paper aims to contribute to the literature on welfare state reform through a different angle, by analysing reform processes through the development of specific policy instruments, namely tax expenditures for social purposes, also known as 'fiscal welfare', which has remained a blind spot in much of the welfare state literature.

Already in 1958, Richard Titmuss had highlighted what he termed the 'social division of welfare', distinguishing between three sources of welfare: *social*, *occupational* and *fiscal* welfare. He noted that most scholarship on the welfare state restricted itself to the world of social welfare, that is the direct public provision of welfare, failing to note the growing scale and distributive tendencies of occupational and fiscal systems – and the ways in which they often ran counter to the distributive directions of the social welfare system. While US scholars have highlighted the importance of fiscal welfare in the American welfare state, in Europe fiscal welfare still remains largely 'the hidden welfare state', despite the growing use of tax expenditures/'preferences' for social purposes.

We make the hypothesis that since the 1990s, in the European context, due to the specific features of tax expenditures, fiscal welfare has not only formed part of the "hidden welfare state" (Howard, 1997), but has also been the hidden part of welfare state reforms. Indeed, we show through a survey of the literature of the past 20 years on welfare state reform in Europe that while tax expenditures are sometimes mentioned in passing in the description of welfare reforms, they are very seldom analysed as an important element in the reform process itself. Yet we argue that, due to the specificities of this instrument, the development of tax expenditures for social purposes can have far reaching consequences on the welfare state.

The paper starts by defining the meanings and boundaries of fiscal welfare and related concepts and provides a literature review of fiscal welfare, which has mainly been analysed in the US context. It then provides a survey of the existing literature on welfare state reform, showing how fiscal welfare instruments represent a largely unchartered dimension of reform analysis. We then discuss the relevance of an approach to public policy reform analysis that goes beyond traditional analyses focusing on politics, ideas and institutions to take instead into account the role of instruments (Lascoumes & Le Galès, 2007).

The final section lays out some hypotheses as to why tax expenditures have become such an attractive instrument for policy making, and discusses the possible long term intended and non-intended effects of fiscal welfare, based on examples drawn from a range of European countries.

I- WHAT IS FISCAL WELFARE AND HOW DOES IT WORK?

A) Fiscal welfare in the literature: a story of particularism and shifting boundaries

1) Fiscal welfare, tax expenditures, and the hidden welfare state: a brief genealogy of related concepts

Fiscal welfare was originally defined as the state's use of the tax system in order to provide subsidies for social purpose. The concept is better understood in the context of Titmuss's theory on the "social division of welfare". In opposition to the idea that the welfare state merely organized redistribution from rich to poor, Titmuss developed a comprehensive understanding of the welfare state, comprising "*all collective interventions to meet certain needs of the individual and/or to serve the wider interests of society*"(Titmuss, 1958:42). These, he argued, could be divided into three main categories, "*social welfare, fiscal welfare, and occupational welfare*".

This model is based on the recognition that the distinction between direct cash payments recorded as social expenditure, and tax allowances treated as "accounting conveniences", is not substantive, but purely administrative. Both types of instruments provide similar benefits: "*the tax saving that accrues to the individual is, in effect, a transfer payment. In their primary objectives and their effects on individual purchasing power there are no differences in these two ways by which collective provision is made for dependencies. Both are manifestations of social policies in favour of identified groups in the population"*(Titmuss, 1958:45). Thus, the division does not correspond to a functional distinction, but arises from "*an organizational division of method, which, in the main, is related to the division of labour in complex, individuated societies*" (Titmuss, 1958:42). In a social policy perspective, Titmuss concludes, taxation "*can no longer be thought of simply as a means of benefiting the poor at the expense of the rich*" (Titmuss, 1958:46).

Titmuss's original insight gave rise to a stream of literature, among (mainly British) researchers of the welfare state (Mann 1991, Rose 1981, Sinfield, 1978, 1989, 1993, 1997, 2012). Research on fiscal welfare in other contexts was conducted to a more limited extent (see for instance Greve, 1994 for Denmark, Kvist and Sinfield, 1996 for a comparison between Denmark and the UK, or Ervik, 2000, for a comparison between the US, the UK, Australia, Denmark, Sweden, Norway, Finland, and Germany.) Examples of policies analysed in these studies include tax breaks for mortgages, the non-taxation of imputed income from homeownership, income deduction for insurance premium, tax-free child allowances, or reduced taxation for the elderly.

While fiscal welfare was first defined in a social policy context, the concept of **tax expenditure** stems from a legal perspective on taxation. Stanley Surrey, an American taxation scholar, first used the term in 1967 to refer to provisions of the tax code conferring tax advantages intended to "achieve non-tax goals" (Surrey, 1970:705). Surrey's original insight was linked to the fact that these provisions constituted an infringement to the principle of horizontal equality: tax expenditures were first conceived as those provisions that raised issues regarding the fairness of taxation. Yet, the final definition is of a more descriptive nature. In opposition to the "*revenue-raising aspects of the tax*", tax expenditures are defined as "*special preferences found in every income tax*", "*departures from the normal tax structure*

(…) designed to favour a particular industry, activity or class of persons” (Surrey and McDaniel, 1985:3). Examples comprise “*permanent exclusion from income, deductions, deferrals from tax liabilities, credits against tax, or special rates. Whatever their form, these departures from the normative tax structure represent government spending for favoured activities of groups, effected through the tax system*” (idem).

Following Surrey, tax expenditures became the object of numerous studies from tax scholars both in the US and internationally (see for instance Bruce 1988, Peters 1991, Levi 1988, Steinmo 1986, 1993, 1995, Webber and Wildavsky 1986). Competing theories of tax expenditures developed; for example, Steinmo (1989) applied the concept to a comparison between Sweden, the US and the UK. He argued that the greater progressivity of the American tax code compared to the Swedish tax code was an important variable to understand the greater reliance on the tax system to provide social policy goods in the United States. Others, like Levi (1988), argued that tax expenditures were necessary transaction costs used to buy off taxpayers' voluntary compliance.

The concept of tax expenditure gave rise to several critiques (see for instance Wildavsky 1985, Prasad 2011). Mainly, these revolve around the difficulties in accounting for tax expenditures as “departure from the fiscal norm”, because this implies to agree on what is the norm, and what is the exception. Although definitional issues are not entirely resolved, and there is no unified accounting system that would easily allow conducting systematic cross-country comparisons, the concept of tax expenditure in itself is generally considered relevant, and is widely used today both in scholarly debates and in practice by governments[1]. Most OECD countries now publish yearly lists of their tax main tax expenditures and the OECD regularly issues publications updating data on tax expenditures in OECD countries.

Related to these two concepts, the notion of **“hidden welfare state”** emerged from political science and the literature on the welfare state. Particularly, it was designed in the US context to refer to what was perceived as a blind spot in American welfare literature, namely “*indirect tools of social policy such as loans, loan guarantees, and tax expenditures*”(Howard, 1997:5) which form “*the constellation of more indirect or “hidden” government interventions (…) that are designed to provide social benefits (…) or shape their private provision*” (Hacker, 2002:12). This ‘hidden welfare state’ (Howard 1997) is made of “subterranean” policies (Hacker 2002) that are present in sectors like pensions, occupational health insurance, housing, health care, childcare, income support, etc. It represents the welfare-related part of a larger “**submerged state**”, defined as a “*conglomeration of policies that function by providing incentives, subsidies or payments to private organizations or households to encourage or reimburse them for conducting activities deemed to serve a public purpose*” (Mettler, 2011:4).

On top of traditional social policy instruments like direct provision and direct financing, the concept of “hidden welfare state” takes into account other government strategies for intervention such as regulation and tax breaks (Hacker, 2002:11). The main idea that comes with the concept is that analysts commonly underestimate the size of the welfare state, while beneficiaries of these tax schemes are often unaware that they are in effect receiving public

1 This does not mean that different countries account for tax expenditures in the same way, although accounting systems like the European System of Account (ESA) in the European Union are making attempts in that direction. Definitions and calculating rules still differ. For instance some countries count the initial revenue loss, while others calculate the final revenue loss, factoring in interactions with other elements of the tax and benefit systems. Yet, although it is not unified in accounting systems, the concept of tax expenditure is now recognized and used in most countries.

transfers. Mettler argues that policies of the submerged state "*do little to instil in their beneficiaries awareness that they have utilized public social benefits*" (Mettler, 2011:37). This is because, as Howard argues, while "*government bureaucrats are easy to spot", "less visible are the networks of third party service providers who deliver healthcare, child care, housing and job training to eligible citizens*" (Howard, 1997:9). Yet, the US hidden welfare state is described as substantial and growing fast: "*38 to 50 per cent as large as the visible welfare state*" according to Howard in 1997, while Mettler argued in 2011 that these policies "*have proliferated in number, and the average size of their benefits have expanded dramatically since the 1980s*" (Mettler, 2011:4).

Parallel to this research, in the 1990s, the OECD started producing data on "*net social expenditures*", in order to "*provide a better and more comparable picture of social efforts across countries*" (Adema, 1997:154). Contrary to gross social expenditures, which do not take fiscal arrangements into account, net social expenditures include tax advantages for social purpose and the indirect subsidization of privately conducted social efforts, the direct taxation of benefit income, and the indirect taxation of consumption by benefits recipients. Thus, both the "claw-back" effect of governments (the money that goes back to the state when public benefits are taxed) and the indirect benefits granted through the tax system are included in the calculus of net social expenditures. Indirect benefits have been designed by the term **"tax breaks for social purpose"** (or **TBSPs**, Adema 1997:158). Two types of TBSPs are analysed. Some "*perform the same policy function as transfer payments which, if they existed, would be classified as social expenditures*"; this is the case, for instance, of fiscal support for families or in-work tax credits. Another category is made of TBSPs that "*are aimed at stimulating private provision of benefits*" – for instance, favourable tax treatments for private health insurance (Adema et al, 2011:29).

Since 1997, the OECD publishes updated data on net social expenditures and TBSPs every two years. Concerns can be raised regarding data quality, as the data used is mainly based on government voluntary declaration, with low (if any) verification. Yet, this work sheds light on the large variety of policy sectors in which TBSPs are found, from family policy, retirement and health care programs, to employment policies, and home ownership. It also demonstrates the large diffusion of this policy tool across national contexts.

Research on net total (public, and privately provided but publicly subsidized) social expenditures shows that the variation in spending for welfare policies between countries is of a lesser extent than previously thought. Apparently large differences were denounced as misleading, because they were merely linked to "*institutional differences in the way in which social objectives are pursued by governments*"(Adema, 1997:164). Accounting for the role of tax systems thus had "an equalising effect on levels of social expenditure to GDP ratios across the countries considered" (Adema et al, 2011:32). However, this "equalising effect" has been qualified in the literature by authors arguing that the reduced distinctiveness between different models of welfare state was only apparent, and was in reality hiding distinctions between different types of fiscal welfare instruments (e.g. refundable tax credits versus tax deductions) affecting social realities in different ways, in particular with regard to redistribution (Ervik, 2000; Castles and Obinger, 2007; Adema et al, 2014).

Articulating related concepts

Suzanne Mettler's definition of the "**submerged state**" is the most encompassing definition related to the object of this article. It includes the largest range of tools (regulation, incentives,

subsidies, payments to private organizations and households) applied to the largest range of policies, i.e. potentially all domains of government intervention. Howard's "**hidden welfare state**" is thus a subpart of the submerged state, which is concerned with welfare policies (with the same wide varieties of tools). Within the hidden welfare state, **fiscal welfare** is made of the subpart that is concerned with tax instruments only. **TBSPs** represent an even smaller portion of fiscal welfare, because of the restrictive perimeter that is adopted by the OECD[2].

As exposed earlier, **tax expenditures** are defined as "departures from the fiscal norm"; this means that the definition of tax expenditure depends on the definition of the fiscal norm, and hence is not stable. For that reason, the concept is harder to align with the others. Tax expenditures might correspond to the part of the "submerged state" that is limited to tax instruments; tax expenditures dedicated to welfare purposes might align with fiscal welfare; but this will vary according to the perimeter attributed to the fiscal norm.

This article looks at the use of specific tax instruments to conduct policies of the welfare state; it seeks to identify the transformative power of this particular form of public intervention, notably in a reform context. In the rest of this article we use the more stabilized concept of fiscal welfare: it corresponds to the relevant policy domain (welfare) as well as to a restricted set of policy tools (tax instruments such as deductions, tax credits, reduced rates, etc.). We exclude from the scope of the present article the discussion on the general tax structure (size, progressivity and predominance of different types of taxation), as well as the level of taxation of social benefit (the claw-back effect). These dimensions are certainly of first order to depict and understand national welfare systems, since they determine the economic, distributive and political properties of a national welfare system. Fiscal welfare, however, is an additional dimension of the analysis: given a general tax-benefit structure, it could be understood as the way taxation is used to modify, correct, complete, or undo social policy.

2) How is fiscal welfare different from social welfare?

In order to gather as many insights as possible from previous research, we did not limit our literature review to "fiscal welfare" as such but also included publications regarding the other concepts described above. This literature, which mainly concerns the American welfare state, contains numerous insights that are relevant in order to pin down the ways in which intervention through the tax system could participate to the transformation of welfare states in a European context.

Some practical characteristics of fiscal welfare instruments described in this literature are of importance in that regard. For one, tax instruments are described as discreet, less traceable than traditional social welfare instruments. This means that democratic and popular scrutiny might be lighter than with traditional social policy instruments. This allows "*policies to pass*

[2] First, although Adema et al. looks at the taxation of benefits, instances of non-taxation or reduced taxation of benefits (which would be included in an enlarged definition of fiscal welfare) are not recorded as tax expenditures. Second, the OECD counts the portion of refundable tax credits that is paid out to households or individuals as traditional cash transfers (and not as a TBSPs), thereby largely under-estimating the real extent of tax breaks equivalent to benefits in cash. Thus, in the UK in 2009 while only £ 1.6 bn spent under the Working tax credit was recorded as a TBSP, £ 6.2 bn was spent on cash payments through the tax system. And while only £ 3.8 bn spent on the Child Tax Credit was recorded as tax support, £ 15.2 billion was actually paid out (Adema et al, 2014:12). Finally, OECD research excludes some policies with a social purpose that are not traditionally classified as such; for instance, it does not count mortgage-friendly tax expenditures, or some tax subsidies for employment policies going to employers.

that would not survive if subjected to the bright light of political scrutiny or the cold calculations of accurate budgeting" (Hacker, 2002:44). Legislative and bureaucratic processes are also different than those that traditionally concern social welfare instruments, with tax officials in charge of them, rather than social policy specialists (Howard, 1997:30). The "inherent ambiguity" (Howard, 1997:11) that characterizes tax expenditures means that they can be embraced on multiple grounds. In that sense, they are described in the literature as an ideal policy tool to cut deals and reach compromises, because they can be framed in many different ways that can suit broader coalitions than traditional "visible" spending[3]. Taken together, these elements mean that fewer veto points characterize the policy process in the US context when using "hidden welfare" instruments (Howard, 1997:179).

Underlying ideological contentions are different. Rather than socialization, instruments of fiscal welfare are often associated with a privatization logic, specifically when they are used to foster the development of occupational forms of welfare. According to Mettler, these policies "*embody the principle of privatization, meaning the contracting out of government responsibilities to the private sector on the assumption that it can deliver goods and services more efficiently*"(Mettler, 2011:18). Fiscal welfare is also associated with a free-market logic, advertising concepts such as individual choice, self-reliance and incentives (Howard, 1997:11, Ervik, 2000:245). For that reason, they would be a better fit with the self-image of the middle class than direct spending (Gilbert and Gilbert, 1989). Fiscal welfare also suits the ideal of "small government" (Mettler, 2011:4). Indeed, tax expenditures are described as a "*less intrusive, less bureaucratic alternative to government regulations or direct expenditures*" (Howard, 1997:8).

Fiscal welfare also participates in shifting power relations in the conduction of social policy. In particular, it plays a crucial role in "*altering the balance between public and private power in society*" (Faricy, 2011:74). According to Hacker, fiscal welfare instruments considerably empower third-party providers with strong vested interests. These providers are then able to mobilize very large resources to maintain the status quo from which they are benefiting (Hacker, 2002:56). These interest groups have both the incentive and the means to block threatening policy developments; since they are often also important providers of job and economic growth, they are indeed in a privileged position to do so. Thus, fiscal welfare would induce a modification of the role of government and a change of nature of the welfare state. Namely, fiscal welfare would confine the government to an overarching regulatory role. State action would shift to "the management and oversight of private actors operating within a new framework of regulatory authority" (Hacker, 2002:319). Private actors come to play the role of "sub-governments" (Hacker, 2002:44), which affects the nature of the welfare state itself (Howard, 1997:12). Thus, these policies would be characterized by the increasing importance of a well-informed minority, paralleled with a general decline in citizens' engagement in policymaking (Mettler, 2011).

[3] Tax expenditures can fulfil different purposes at the same time; they can be portrayed strategically and defended on multiple grounds, depending on the audience. Howards notes four basic ways in which tax expenditures can be portrayed: "as aid to some needy category of citizens; as a subsidy to third party providers in the private sector, who furnish most of the goods and services underwritten by the tax code; as tax reductions; and as alternatives to traditional government programs (i.e. direct expenditures and regulation)"(Howard, 1997:11). Employer pensions in the US have been defended as "a way to guarantee retirees income security, reduce inequities in the distribution of retirement income, defend the gains of organized labour, check the growth of Social Security, reduce the need for public assistance, or ensure the integrity of a massive pool of capital" (Howard, 1997:184). This "plasticity" explains that tax expenditures can be supported by broader coalitions than direct expenditures, with some politicians also trying to kill several birds with one stone.

Difference in redistribution profiles

Fiscal welfare is also different from social welfare in that it generally does not have the same redistributive effect. A large part of the existing studies on fiscal welfare precisely focus on its redistributive aspect. Many of these studies highlight the regressive character of fiscal welfare instruments. Titmuss's argument (1958) was precisely that occupational and fiscal welfare were means of directing state's resources towards the middle-class and the well off. Surrey (1970:720) highlighted the adverse effect of tax expenditures on equity between taxpayers at the same income level and at different income levels. The analysis conducted in 2007 in OECD countries by Castles and Obinger concludes that the use of fiscal welfare favours redistribution from poor to rich. Thus, "*means testing in the hidden welfare state refers to an abundance and not a shortage of means*" (Howard, 1997:34). Indeed, the progressivity in the rate means that upper-income taxpayers generally benefit more from tax expenditures (Howard, 1997:31). This "*heavy distributional skew*", Hacker argues, is very distinctive of fiscal welfare as an object of study (Hacker, 2002:39). In addition, fiscal welfare rewards behaviours that "*less affluent taxpayers cannot afford to engage in (e.g. owning a home)*". Occupational tax benefits are also more likely to concern workers with secured employment, in large companies and relatively high wages.

Beyond this generally regressive impact, numerous evaluations show more precisely that fiscal welfare often benefit most the middle and upper middle classes (e.g. Avram 2014; Adema, Fron and Ladaique, 2014; Carbonnier and Morel, 2015). According to Howard, it is "*no coincidence that so many beneficiaries (are) middle – and even upper middle class*" (Howard, 2007:91): this effect would result from a precise targeting operation on the part of politicians trying to attract middle class votes.

Yet, the literature also reveals examples of progressive fiscal welfare instruments, precisely calibrated to attract the sympathy of low-income voters. Some tax expenditures are explicitly targeted at low-income people: in the British context, commentators have coined the phrase "redistribution by stealth" to describe Gordon Brown's large recourse to tax expenditures for social and employment policy (through, e.g. the *Working Tax Credit,* or the *Child Tax Credit).* The French *Prime Pour l'Emploi*, a tax credit that fosters progressive redistribution is another example. In the US, the implementation of the Earned Income Tax Credit (EITC) was the result of party competition for the vote of the working poor (Howard, 1997:188).

Thus, fiscal welfare instruments certainly participate in redefining welfare states' redistribution system, in a regressive or progressive direction, depending on their specific design. Tax expenditures incentivizing private spending tend to have a regressive distributive impact. Some specific refundable tax credits turn out to foster progressive redistribution. In terms of the net after tax effect on inequality, an intensive use of tax instruments is correlated with a lower reduction of inequality (Castles and Obinger, 2007).

3) How is fiscal welfare transformative?

Beyond the static description of tax-based social policies, the literature on the American hidden welfare state also contains hypotheses regarding the transformative power of those policies in a dynamic reform context.

Authors evoke the mobilization of fiscal welfare by Conservative governments, in order to reform a social policy through a "layering" technique: private programmes, publicly

subsidised through tax expenditures, are discretely added on top of direct spending programmes, in order to attract beneficiaries to the new layers and away from the former ones. That way, instead of an upfront retrenchment policy, Conservatives manage to curb the demand for traditional direct spending programs, thus appeasing "those who might otherwise be vocal proponents" (Mettler, 2011:18, see also Hacker, 2002:51) According to Howard, this has been "the general pattern" of social policy making in the US in the twentieth century (Howard, 2007:90).

Fiscal welfare instruments could also be mobilized in "starve the beast" (Bartlett 2007) strategies, in order to limit the future growth of direct spending programs, through reducing available public revenues. This is the essence of Howard's "strong suspicion" that tax expenditures are used by Conservatives "as an expedient (if second-best) means of choking off tax revenues for programs they dislike" (Howard, 1997:4).

Finally, Howard describes the ability of tax instruments to develop in autonomous, uncontrolled and unpredictable ways (Howard, 1997:189). Once tax expenditures are embedded in the tax code, they can be influenced by demographic changes, by other changes in the tax code, by changing behaviours, or by the emergence of new social phenomenon, in ways that are largely unpredictable (Howard, 1997:183). Historical contingency, and unintended consequences are fundamental elements to take into account when studying fiscal welfare: this is at the root of what Howard calls the "growth without advocacy" phenomenon of the hidden welfare state (Howard, 1997:91).

All of these hypotheses have been developed in the American context. Although they can probably be very helpful in trying to understand the European case, major differences are also at play and must be taken into account. Thus, these insights need to be adapted to the reality of European welfare states. Beyond, the specificities of very large and mature welfare state, governed by very different political and institutional mechanisms, and answering to the needs of very different constituencies, call for the development of new original hypotheses regarding the transformative power of fiscal welfare in the context of reforms of European welfare states.

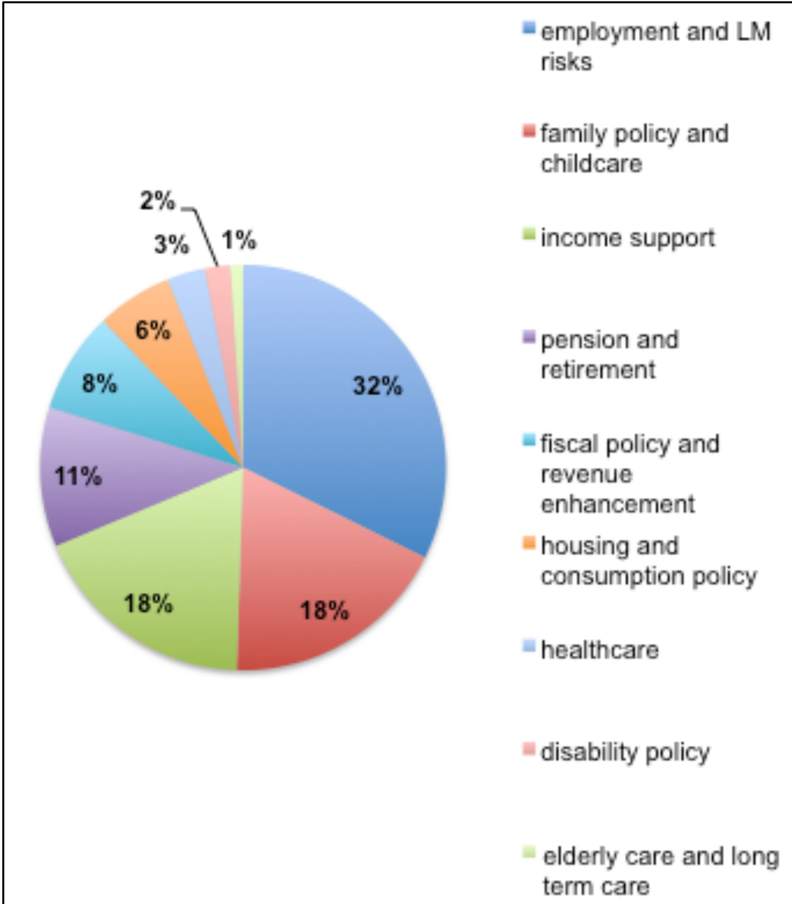
B) Fiscal instruments as the hidden dimension of processes of welfare reform in Europe: incidental knowledge in the literature

Preliminary inquiries in the subject of fiscal welfare led us to the intuition that the use of the tax system to conduct welfare policies in European welfare states, especially in reform contexts, was not necessarily a new reality but rather an understudied one. For that intuition to be true, examples of fiscal welfare instruments would be at least mentioned in former studies of welfare state reforms. In order to verify that, we selected 37 major books on welfare state reforms published in the last 20 years (see the annex for the specific list of books and the criteria that presided over their selection). We conducted a systematic text analysis with a list of 17 keywords such as "tax expenditure", "tax credit", "tax deduction", etc. (complete list of keywords in annex). Out of the 37 books, 12 were not available in an electronic version. Two books gave no results at all for any of the keywords. In the remaining 23 books that were analysed, we found 233 relevant occurrences. 209 could be meaningfully analysed (i.e. we were able to read the whole paragraph or section that included the quotation).

Our intuition that the use of fiscal welfare was an understudied reality in European welfare states was confirmed, since we found references to such instruments in 16 European

countries, clustered in nine major welfare policy domains. Some of the instruments described date back from the 1970s, while others are very recent (post-2010). The proportion of occurrences by policy domain is illustrated in the following graph. Obviously, the relevance of this graph is limited; it is only a description of our sample, and should not be read as hard data. It is only included here as an indication of the diffusion of those tools across policy domains. It also provides us with a snapshot of the incident knowledge about fiscal welfare instruments in Europe gathered so far.

Figure 1: Repartition of occurrences by policy domain in our sample



Out of the 209 occurrences that we considered "meaningful", 56 corresponded to theoretical discussions of fiscal welfare instruments as concepts, without reference to any particular instruments. 153 occurrences were references to concrete existing instruments. In these 153 occurrences, 73 were static descriptions of welfare arrangements comprising fiscal welfare (although it was generally not labelled as such, but merely included in the description of a larger welfare policy). 80 occurrences were mentions of fiscal welfare instruments mobilized in a dynamic reform context (although, again, this was our interpretation and was not analysed as such in those books). We further excluded occurrences for which we lacked relevant descriptive characteristics (country and date of the reform, type of instrument, policy domain, stated reform objective…). We obtained a list of 65 occurrences where fiscal welfare instruments were used in a process of welfare state reform about which we had sufficiently detailed information to conduct a meaningful analysis. Observations regarding this sample of fiscal welfare instruments in reform contexts that are 'incidentally' mentioned in the literature are summarized in the following table.

Policy domain	Main type of instruments*	Type of benefits	Examples of reform	Typical reform
Employment and LM risks	In-work tax incentives (*making work pay)*	Equivalent to cash benefits	Canada, 1990s	wage subsidy in the form of a tax rebate on low wage jobs, designed to incentivise the demand for work (ex: 'PPE' in France, 'WFTC' in the UK, 'jobbskatteavdrag' in Sweden)
			United States, 1990s	
			France, 2001	
			Belgium	
			The Netherlands	
			United Kingdom, 1997	
			Sweden, 2010	
			Nordic countries, early 2000s	
	Employer's payroll taxes exemptions (r*educing labor cost /supply side measures)*	Subsidies directed at firms	The Netherlands, 1997	exemption on employer's social security contributions for a certain type of jobs, designed to incentivise their creation
			Spain, 1993/1994	
			Italy, 2000s	
			Germany, 2004/2005	
			Germany, 2009	
			United Kingdom, 2009	
			Belgium, late 1990s	
			France, 1993	
Family policy and childcare	Child related tax allowances	Equivalent to cash benefits	Canada, 1979, 1993	tax credit or allowance for families, with an amount dependant on the number of children and their age (ex: Quotient Familial in France)
			Austria, 1990s	
			Germany, 2010	
			United Kingdom, 1997	
			Spain, 2011`	
			United Kingdom, 1990	
			Germany, 1990	
	Tax deductions for childcare expenditures	Conditional on private expenditure	Austria, 1970s	tax deduction for external care expenditures (ex: 'déduction des frais de garde d'enfants' in Belgium)
			Germany, 2005-2009	
			Germany,1998-2005	
			Belgium, 1980s	
			France, 1994	
Income support	In-work tax benefits for the working poor	Equivalent to cash benefits	France, 2001	tax rebate to top-up low wages
			The Netherlands, 1980s	
			Sweden, 2010	
	Keynesian-type transfers through taxation (for pensioners, low-income people, jobseekers…)		Germany, 1990	tax reduction for pensioners
			Sweden, 2010	
			Spain, 2008/2009	
			Spain, mid-1990s	
Pensions	Tax incentives for supplementary pensions (personal savings account)	Conditional on private expenditure	Germany, 2001	exemption of pension contribution from income tax, tax-free returns on investment
			The Netherlands, 2004	
			United Kingdom, 1993, 1995	
			Spain, 1989	
			France, 2004	
			Austria, 2000s	
	Occupational pension plans (payroll or corporate tax exemptions)	Subsidies directed at firms	France, 2004	exemption of pension contribution from payroll taxes

*This is not an exclusive list

Beyond the information gathered in that table, we could also identify several "reform trends" that seemed particularly characteristic of the presence of fiscal welfare, across our observations. For example, fiscal welfare instruments seemed to be used often in activation reforms, and more precisely in reforms implementing "active labour market policies". The presence of tax instruments in reforms which aim was to reduce the cost of labour was also noticeable. There were also many mentions of reforms where the suppression of previously existing fiscal welfare instruments was used to broaden the tax base, often as an alternative to rising tax rates. In this category, several occurrences concerned the suppression of fiscal welfare instruments in the post-crisis context since 2008. We label this the 'adjustment variable' property of fiscal welfare. Paradoxically, fiscal welfare instruments were also evoked as part of stimulus packages that were implemented after the outbreak of the financial crisis in 2008.

C) The role of instruments in the analysis of public policies and their reforms

Much of the literature on welfare state reform emphasizes the role of politics and ideas ('powering' and 'puzzling') in shaping the reform process, as well as the role of institutions in constraining such processes of reform (path-dependency). In their seminal contribution, Streeck and Thelen (2005) have helped pave the way for a more subtle analysis of reform trajectories by highlighting different mechanisms at play that lead to incremental institutional change with transformative results. Amongst these mechanisms, transformation through 'layering', linked to the introduction of new instruments on top of traditional ones, has been highlighted. This attention to the role of policy instruments in processes of reform is by no means new. Indeed, changes in policy instruments was one of the dimensions of policy reform identified by Peter Hall (1993) who distinguished between three orders of change – changes in the overarching goals that guide policy in a particular field; changes in the techniques or policy instruments used to attain these goals; and changes in the precise setting of these instruments. The renewal and diversification of public policy instruments, not least in relation to new forms of governance (amongst which the development of 'New Public Management'), has also been in focus for public administration scholars. Despite this, as Lascoumes and Le Galès have highlighted, the analysis of the role of policy instruments has by and large remained quite peripheral to the understanding of public policy. In fact, "public policy instrumentation and its choice of tools and modes of operation are generally treated either as a kind of evidence, as a purely superficial dimension [...], or as if the questions it raises (the properties of instruments, justifications for choosing them, their applicability, etc.) are secondary issues, merely part of a rationality of methods without any autonomous meaning" (Lascoumes and Le Galès, 2007:2).

This is perhaps even more true of fiscal welfare instruments, as the above review of the literature on welfare state reform illustrates: even when mentioned, the introduction of such instruments are only mentioned in passing, rather than analysed as an intrinsic element of the processes of reform. Yet, as Lascoumes and Le Galès (2007) argue, public policy instruments are bearers of values, fuelled by specific interpretations of the problem at hand and by precise notions of the mode of regulation envisaged. Thus, the types of instruments used, their properties and the justifications for these choices may be seen as important tracers of change in both policies and in forms of governance and public priorities.

The role of discreet instruments in processes of welfare reform has been well brought to light by Palier (2007) in his analysis of how the introduction of a specific instrument, that of

funded pensions, has enabled a gradual but profound transformation of the French pension system, otherwise described as particularly 'frozen' in the welfare state literature. Closer to our own interest, Pollard (2011) has shown how the development of tax expenditures in France, and in particular in the field of housing, has led to a transformation in both the norms of public action (based on incentives rather than allocation) and in terms of outcomes which include a weakening of the State's governing capacity and an increase in social inequalities.

Thus, tracing the development of this specific instrument, in this case fiscal welfare instruments, opens very fruitful avenues for developing a subtle understanding of welfare reforms that reflects both normative changes in public action and incremental institutional changes with both intended and non-intended effects.

In what follows, we draw on the existing literature and on our own analysis of fiscal welfare instruments in Europe, and in particular on the case-study of France, to formulate hypotheses regarding both the reasons for the expansion in the use of fiscal welfare instruments and the effects of these instruments on welfare governance and policy outcomes.

II - THE TRANSFORMATIVE POWER OF FISCAL WELFARE: HYPOTHESES AND EVIDENCE

A) Fiscal welfare as a tool for reform

1) A tool for organizing private markets

A first hypothesis, clearly born out by the US example, is that fiscal welfare instruments can be used for fostering and organising private markets, such as in the fields of healthcare or pensions. Not only do tax incentives support private activities, they also determine the form and content of the service delivered as well as the pattern of competition between service providers. The privileged instrument to do this use is tax expenditures conditional on a private expense (tax subsidies to service producers may also exist).

Tax expenditure schemes aim to stimulate either supply or demand of such services. By creating incentives for firms to develop their activities and by supporting the demand, these tools can foster the creation of a previously non-existant private market for social services, or favour their expansion. For instance, in a number of Continental and Nordic countries, tax credit schemes have been introduced with the explicit aim of fostering the development of a personal household service sector. Here the aim has been not only to create jobs in the low-skilled service sector, but also to respond to care needs. In countries where care services were underdeveloped, such as in Continental Europe, the development of this private but publicly subsidized personal services sector aims, in part, to respond to these care needs, but in other countries, in particular in the Nordic welfare states where universal public care services were in place, such publicly subsidized private services are meant as a complement, and possibly as an eventual substitute, to the public care sector. In this case, the tax credits scheme introduces an additional layer on top of existing social welfare schemes, which may eventually come to displace the original policy (Morel, 2015; Carbonnier and Morel, 2015).

In countries where mandatory generous public insurances prevail, private insurances tend to be crowded out: the demand for insurance is already addressed, and a large share of workers' gross wage is already dedicated to social contributions to the mandatory public insurance. In

that context, fiscal welfare instruments prove to be a convenient tool to favour the development of the private sector, precisely by diverting earmarked public resources towards private schemes. For example, employers' contributions to collective private social insurance (health and/or pensions funds) can be partly exempted from contributions to mandatory social insurances[4]. Such an arrangement allows a partial transfer of public resources to private schemes: instead of paying a share of labour cost through social contributions, this share goes to a private insurance. In France in 2011 the resources diverted from social security to private insurance amounted to at least 4.5 billion euros for health insurance and 2.5 billion euros for pensions while the market for private insurance amounted to 30 and 10 billion euros respectively (Zemmour 2013). Thus the use of fiscal welfare directly participates in shaping a private market.

In addition to creating or supporting the market, fiscal welfare also determines its production. Indeed tax expenditures conditional on private consumption need to be associated to a legally defined service. And this specification is an opportunity for the government to formulate what it wants the market to produce. It could either restrain the target either to approved providers or, more often, to services fulfilling certain characteristics. By doing so, other services, in a business close to but excluded from the target of the tax breaks, are disadvantaged (the stronger the incentive, the stronger the effect). A case in point is the private market for health insurance in France, exposed by Turquet (2006) and Kerleau (2009). Private health insurance contracts are supported by a payroll tax exemption that amounts to around 25% of the price of the contract. Yet this tax expenditure is restricted to i) contracts made mandatory in the realm of a collective agreement, and ii) contracts offering a minimal "basket of care" and excluding certain forms of risk selection. The introduction of this tax credit (which has been subjected to several evolutions during the 2000s) has strongly disadvantaged other forms of health insurances (such as individual and voluntary contracts), which used to dominate the field, and has created a strong incentive for providers to redefine their offer in order to fulfil the eligibility criteria. The on-going reorganisation of the sector of private health insurance in France (in favour of corporatist private insurance contracts) cannot be understood at all if this dimension is not taken into account (e.g. Batifoulier, Domin and Gadreau, 2008; Dormont, Geoffard and Tyrole, 2014). Thus, far from being a rollback of public intervention in favour of a "free" market, the fiscal welfare scheme here is a (costly) mean to develop a private market and organise it.

2) A practical tool (institutional aspect)

a. Avoiding traditional circuits: changing institutional actors [to be developed]

Tax expenditures are discussed in specific institutional arenas, which are different from the traditional social policy arenas. This is likely to impact the reform process in different ways (and thus to make the tool a practical one to conduct reforms in certain circumstances):

- Actors involved are different (different backgrounds, different organisational cultures, etc.)
- Negotiation processes are different: since they can be discussed outside of traditional social policy areas, using fiscal welfare instruments can be a way to avoid the social policy elites (trade unions, well-informed and engaged social policy officials…)

[4] This exemption is conditional on a certain set of conditions concerning the private insurance.

- Overall objectives of reforms in which one particular mechanism fits are different between the Ministry of Finance and the Ministry of Social Affairs

b. Easy enacting : agenda setting and processes

Reforming institutional aspects of social policy often requires passing a social bill. Yet, for both institutional and political reasons, the window of opportunity to pass a bill on social policy does not open often, and can be costly (in political terms as well as in time investment). Since a large number of laws on different topics are passed every year, some minor measures can be passed in any omnibus bill, but more important changes require a specific bill. On the contrary, the window of opportunity to create, modify or suppress tax expenditures opens at least once a year (possibly more often) through the budget bill. It is, so to speak, permanently open. Thus, when a government wants to intervene quickly on a social topic, the less costly way (from a legislative point of view) and the fastest one could possibly be to modify the tax code by writing an additional article to the budget bill. Any measure taking this form can be technically implemented within at most one year (in practice, a decision passed in November can even be effective in January), whatever the constraints on the legislative agenda are.

It is not easy to show evidence of this flexibility in the French case since changes in tax expenditures legislation are systematically recorded by officials only since 2009 (i.e. a period where cuts where far more frequent than creation). However this can be illustrated by the changes in the legislation concerning care for the elderly. The two main schemes for dependant elderly are an in-kind benefit ("allocation personnalisée d'autonomie") and a tax reduction[5]. Both schemes are designed to support the cost of personal care, the former targeting rather the most needy (the amount is mean-tested) while the latter is mostly used by the wealthiest (Carbonnier, 2015). Between 1991 and 2014, there were three legal changes of the in-kind benefit (concerning its scope, eligibility, etc.) in 1997, 2001 and 2003; these three reforms were each included in a specific bill, each passed in the parliament in three months. During the same period, comparable changes to the tax reduction (ceiling, eligibility) happened eight times, mostly through simple articles in the budget bill (1992, 1995, 1997, 2002, 2003, 2005 and 2011) (Carbonnier, 2015).

c. Playing around accountability rules in a fiscally constrained context

From a theoretical point of view, a government seeking to balance its budget has no reason to prefer a tax expenditure to a direct expenditure. It is theoretically equivalent in terms of deficit. Moreover, European treaties (Maastricht Treaty, TSCG) are concerned with the fiscal (im-)balance, not by an absolute level of expenditure and/or revenue. However, in practice, there could be several good reasons for policy makers to use tax expenditures when the fiscal constraint on public spending is strong.

First of all, the formal control of public expenditure is stronger than the control of the budget balancing. Indeed, when passing the budgetary bill, the voted level of expenditure is binding. Thus if expenses exceed authorized credit, a corrective bill is required to pay additional

[5] However the tax reduction is not restricted to elderly care but also includes a variety of personal household services for all types of households, irrespective of care needs.

expenses (otherwise the last claimants will not perceive their benefit)[6]. But tax revenue underwritten in the budgetary bill has the legal status of mere previsions (conditional on economic hypotheses of the government). Consequently if tax expenditures happen to be much costlier than expected, their unforeseen cost will not entail any automatic reaction and the tax credit will benefit each eligible taxpayer fulfilling the requirements.

Second, the monitoring of tax expenditures is incomplete. Some cases of "departure from the fiscal norm" are not recorded as tax expenditures and their cost is not properly assessed on a regular basis (this is typically the case for exemptions[7], and even more social contribution exemptions). More generally, due to the uneven quality of tax credit estimation, it could be very difficult to estimate the cost of a tax breaks both *ex ante* and *ex post*. For instance, an appendix ("Voies & Moyens Tome II") to the French budgetary bill indicates a value for each recorded tax expenditure and adds a qualitative indication of the estimation ("Excellent", "Reliable", "estimates"); some of the tax breaks are reported with a cost of "ε" (i.e. negligible) whereas other are reported with a cost "not reported". For 2009, more than half of the tax expenditures were not evaluated. In 2010, only "estimates" were available for a large number of tax expenditures (Pollard, 2011). Moreover the estimated cost of tax expenditures is often exactly the same from year to year (which indicates that neither the effect of economic activity nor the effects of inflation are actually taken into account in the assessment).

Consequently the skyrocketing cost of one tax expenditure may well remain unnoticed for a while (several years); in such a case, the revenue loss will be considered lost in the vast gap between tax prevision and tax collection[8]. Conversely the traceability of public expenditures being excellent, the unforeseen drift of the cost of a social benefit cannot remain un-addressed for more than a few months. This characteristic may lead to underestimate the cost of tax expenditures and thus to make it easier to vote. For instance in 2003, right-wing governments implemented a pension reform the main purpose of which was to balance the pension system in the long term. All measures of this reform had thus to be examined *ex-ante* to estimate their budgetary impact. However one scheme included in the reform had no estimated cost: a social contribution exemption for employer contributing to certain types of collective private pensions.

Eventually, public strategies implemented by governments to balance their budget in the long run consist in commitment devices tying their own hands. To do so, the French government has adopted in 2003 a rule according to which the real value of central government expenditure (excluding interests) should not grow (this is called the "zero volume" norm). Moreover the European commission (who theoretically should only look at the deficit size) pays a particular attention to the total amount of public expenditure. Thus for a decade now, French policy makers have had to deal with a binding ceiling of total expenditures. Moreover, the budget is built around thirty "Missions", each of it having a credit ceiling, that neither the minister in charge nor MPs have the power to overcome.

[6] Things are different concerning benefits paid on social security funds.

[7] i.e. the fact of excluding certain types of revenue or transaction from the regular tax basis.

[8] The revenue loss due to a tax expenditure may also be overestimated, which can also be problematic in times of retrenchment: in the latter case the cut of a tax expenditure will not necessarily increase the tax revenue as much as expected.

In this institutional context, tax expenditures appear as the typical loophole: it is a technical device for policy makers to reinforce public interventions without formally breaking the rule of freezing public expenditures[9] and without breaking credit ceilings.

3) A politically attractive tool

a. Addressing new social risks and modernizing the welfare state

As can be seen from the indicative data in figure 1, tax expenditures across Europe seem to have developed in particular in the fields of labour market policy, as well as family and childcare policy, that is to say in relation to what have been termed 'new social risks'. The use of tax expenditures in these areas can be understood as offering room for manoeuvre for governments to respond to these new needs in a context of budgetary austerity since such expenditures, as we have seen, do not need to be accounted for in as strict a way as direct budgetary expenditures. They also allow governments to appear as more 'responsible' by enacting policies that are based on tax cuts rather than on increased spending.

Furthermore, tax expenditures are also easier and, at first sight, cheaper to implement, as they do not necessitate the setting up of a specific bureaucracy to examine claimants' applications and to manage the payments. Beneficiaries simply indicate in their tax file the deductions / reductions they are entitled to (for instance for the purchase of childcare or household services or in the case of home renovations). Tax expenditures can be portrayed as part of a modernisation of welfare bureaucracy based on a leaner and less intrusive state.

Tax expenditures also seem to fit well with the dominant discourse and drive towards 'individualisation' and 'free choice' in the field of social policy. With respect to childcare for example, tax expenditures enable parents to purchase the types of services they wish between competing providers, rather than imposing a 'one-size fits all' public childcare service for instance. In the field of labour market policy, tax expenditures seem particularly well-suited to the purpose of 'activation' and of 'making work pay'. In fact, because such tax expenditure schemes aim at activation (rather than decommodification) and the promotion of a variety of non-state service providers, such schemes are likely to benefit from the support of non-traditional welfare constituencies, such as employers and Right-wing parties. As such, it is possible to achieve broader support coalitions for such policies than for traditional policies based on direct budgetary spending, particularly as these tax instruments can appeal differently to different political actors (as can be seen from the fact that both Right- and Left-wing governments have made use of them, albeit with – at least in some cases - different distributive aims).

b. A tool for reducing conflicts

Not only can the versatility of tax instruments make them a source of compromise across the political spectrum, such instruments are also less prone to public scrutiny and debate.

[9] At least as long as tax expenditures are not considered as public expenditures. Indeed, the EAS 2010 (European accounting system) recommends considering some of the tax credits as public expenditures; yet most of tax expenditures remains considered as revenue loss and not as expenditures.

Because they are seldom recognized as social benefits, tax expenditures do not mobilize the same public attention as direct social expenditures. This means less debate and formal negotiation, less media exposure, and finally less conflict. For instance, the tax subsidies for employers contributing to private health insurance plans legally modified in 2003 was barely noticed by commentators and did not trigger debate or opposition, while the general law on pensions was generating public outrage at the same time. The cost of this exemption is not even reported on a yearly basis. It has been evaluated by several public reports, but only since 2010. There is no consensus either on the actual size of the exempted tax base or on the cost in terms of revenue loss. The order of magnitude however amounts to at least 7 billion euros (0.3 points of GDP) (Zemmour 2013).

- The increase in tax credits for personal services was announced during discussions of the tax bill ; one way to measure the 'reduced scrutiny' argument would be to compare the length of parliamentary debates concerning those measures and equivalent social spending in the same year.

Thus, in hard times when political opposition and public finance scrutiny are strong, fiscal welfare would be a means of avoiding the institutional "stasis" through processes of back-door channelling and subterranean politics.

B) The long term intended and non-intended effects of fiscal welfare

The use of tax instruments for social purposes is likely to produce both intended and non-intended effects. Amongst the intended effects, tax instruments can be used strategically to progressively displace existing schemes through 'layering', or in a 'starve-the-beast' strategy of reducing state revenues, thus accentuating budgetary constraints, in order to establish a political and ideological climate favourable to cutbacks in public expenditures. Intentionality is however difficult to prove, and in fact there may well be also some more unintended effects of fiscal welfare, that are linked to the specific characteristics of the instrument.

1) Institutional layering and 'starve the beast' strategy

Fiscal welfare instruments provide a tool for fostering the private sector in social insurances and social services, on top of the existing public option. In such a way, fiscal welfare allows for a discrete form of (partial) opting out from public insurances and services, without engaging in upfront cutbacks of these public options. Here the intended effect is that of an incremental displacement from public to private sector provision, or at least a displacement of a certain part of the population and the maintenance of a public option for the poorest, with potential dualizing effects in the field of social protection (cf. Spies-Butcher and Stebbing, 2010).

An example of this is the introduction of the tax reduction for household services in Sweden, which has been shown to contribute to the marketization of eldercare services (Szebehely, 2011; Calleman, 2015). While the tax reduction is open to all households independently of care needs, it is particularly used by elderly people as a way to top-up the public home-care services they receive in a context where the provision of such services has been declining. It is also often less expensive for elderly people with higher incomes to purchase private services with the tax reduction than to pay for the public, means-tested home-help services.

Thus, not only has a private market for the wealthier elderly been created, it may also in the long-run lead to incremental changes in the publicly financed sector as expectations vis-à-vis the public sector are lowered, but also as budgetary constraints become greater due to the lower fiscal revenues these schemes entail. While this remains speculative, one could argue that these fiscal policies may well amount to a 'starve the beast' strategy (Morel, 2015).

Starving the beast is a strategic move that consists in cutting public revenue in order to put political and financial pressure on cutting expenses (see Bartlett [2007] for a history of the concept and its diffusion). The literature lacks evidence on the general efficiency of this strategic move, since history is full of episodes were tax revenue was cut and expenditure raised at the same time. It is also difficult to "prove" that policy makers repeatedly implementing rather small tax breaks consciously followed an explicit strategy to starve the beast. Yet the accumulation of tax breaks over time tends to diminish public resources in the long run. In France, the "starve the beast" image may be relevant in at least in three respects.

First in a context where public budget is under particular scrutiny, it could be difficult to support and obtain a general tax cut through a diminishing of statutory rates (especially as far as personal income tax is concerned). Thus fiscal welfare is a means to reduce the tax pressure while leaving the statutory tax rate unchanged (and relatively high). Since public debate generally focuses on the statutory rate (and more precisely the marginal statutory rate) rather than the actual implicit tax rate, the accumulation of tax expenditures creates the paradoxical situation, where taxation is publicly described as too heavy (creating pressure for a general tax cut) and where the tax revenue is in fact low (because of the intensive use of loopholes created by fiscal welfare, by a small number of tax payers).[10] To give a better idea of this phenomenon, in 2011 tax expenditures for the sole social purpose (there are many others) on personal income tax amounted to 49% of the actual revenue collected (51 billion euros). This tax expenditure consisted in €7.5 billion of incentives to private social expenditure, €11.5 billion of child tax credit, and €6 billion of tax expenditures comparable to cash benefits (in-work tax credit, higher education tax credit, etc.) (Zemmour 2013). Put differently, for the political groups promoting a form of taxpayer revolt, fiscal welfare has been a good deal since it has addressed their concern, while leaving them the political leverage provided by a high level of statutory tax rate. In the French context, the point can be clearly made both for personal income tax and for corporate taxation (whose statutory and implicit tax rates strongly diverge).

The second aspect of the "starve the beast" dimension concerns social security funds. Indeed, whereas running high public deficits is not a problem *per se* for the central government (i.e. as long as the interest rates make the financial load manageable), Bismarckian type of social security funds are supposed to be permanently balanced. In the French context, in spite of being relatively low, the deficit of "la Sécurité Sociale" has been permanently put forward to advocate for retrenchment reforms in order to "save the system" (Palier, 2005; Duval, 2007). And a look at the figures clearly shows that the order of magnitude of this deficit is comparable with the revenue loss of the funds due to fiscal welfare programs. Indeed, in spite of partial reimbursement of tax expenditures by the central government (1 point of GDP per year), fiscal welfare sharply reduces the revenue of social insurance funds (social security, unemployment insurance and public occupational pensions), for instance through incentives to subscribe to collective private insurance. The revenue loss due to the sole social contribution breaks for private health insurance and pensions amounted to €7 billion in 2011

[10] This situation has been underlined for a long time by Piketty's analysis of French income tax (e.g. Landais, Piketty and Saez, 2011).

(Zemmour [2013]) while the deficit of all social insurance funds amounted to around €16 billion.

3) Reframing public debate

- Faricy and Ellis (public opinion surveys on tax expenditures vs direct expenditures)

4) Long term redistributive effects and support for the Welfare State

- Zemmour: progressivity and support for Welfare States

5) "Growth without advocacy"

Once in force, tax expenditures can grow by themselves. This is true for tax breaks similar to cash benefits (as it is for cash benefits). But this is even truer for tax breaks that are conditional on agents' behaviour. In 2003 a reform of collective private pensions of the third pillar (PERCO) has been implemented including a generous social contribution exemption. The coverage of collective private pension plan (PERCO) kept growing among firms and employees (8% of employees in 2007, 18% in 2012) [11] and the collected contribution to this plan has increased by 50% between 2005 and 2009; it has then dropped dramatically even below its 2005 level in 2012, probably because of the economic downturn. This scheme, built over a strong fiscal incentive, may well sleep for a while or spread very fast, depending both on the socio-economic context and on the response of agents to the tax incentive.

This example stresses the discrepancy between the initial instauration of tax expenditures and the autonomous evolution of the scheme, its cost, its use, without monitoring of this public policy. This characteristic is convenient for policy makers: the prime minister didn't have to take position on the importance that private pension should play in the future (which was clearly an explosive issue). Neither did he have to define a budget, financial prevision or projection, as it is usual for pension reforms. He simply opened a possibility, based on the free will of social partners, leaving the market and the circumstances to decide whether private pensions will grow (or not).

Another case for autonomous growth of fiscal welfare can be found in the personal household service sector. After having been targeted by numerous tax and social contribution breaks, the number of workers in the sector has almost doubled since the mid-1990s. This is partly due to the incentive, partly to tax optimization of firms "entering" the sector to benefit from the tax incentive without changing the content of their activity (eg. teaching, repairing activities etc.).

C) Changing context and new use

- Turning point 1990s: not possible to spend / raise tax because of tax competition:

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[11] http://travail-emploi.gouv.fr/IMG/pdf/2014-053.pdf

http://www.drees.sante.gouv.fr/IMG/pdf/er914_retraite_supp-mel.pdf

Pierson 2001 p. 171, about the impact of tax competition on the financing of the welfare state "Clayton and Pontusson argue that (…), **by limiting the use of the tax code as a means of boosting investment and employment, life is made a lot harder for social democratic governments.** (...) the average total tax ration of the 18 most advanced (and largest) OECD counties has stagnated since the mid 1980s and has failed to keep up with increasing public expenditures. **Tax competition may not be the main cause of the financing problems of the welfare state, but it has constrained policy responses** by making some forms of revenue raising more costly at a time when pressure for increased spending abound."

- In that context, tax expenditures could have been a solution to keep spending on social policy without raising tax rates

- But fiscal welfare is also often used as an adjustment variable in fiscally constrained (either following a crisis or more generally when tax rates can't be raised) contexts: Denmark 1985, 1993, 1998, Sweden in the 1990s, New Zealand and Australia late 1990s, United Kingdom in 1997…)

- In that regard, the 2010s could be a new turning point. We witness more intense fiscal surveillance (especially in EMU). Tax expenditures are slowly taken into account as well: evolution of the "règle de gage" in 2011, new European System of Account 2010… New technology to account for tax expenditures.

- Indeed, since 2010, the strong fiscal constrain as well as the renewed attention to tax expenditures in accounting systems could explain the multiple examples, in European countries, of the use of tax expenditures as an adjustment variable in order to restore a fiscal balance: tax expenditures are suppressed in order to "broaden the tax base" (United Kingdom 2010, Greece 2010, Portugal 2010, Ireland 2010, France 2010…)

In France since 2010, we witnessed a general policy of suppressing loopholes (reduction of ceiling on *Quotient Familial*, freeze of *Prime Pour l'Emploi*, suppression of the tax credit for a child in higher education…) This might be done more easily than direct expenditures, because of the specific legislative process it is attached to: the ceiling on *quotient familial* was lowered in *loi de finance,* as well as the freeze on *PPE* (see full argument above).

- Interestingly, one sector where this isn't happening is employment policy. This could be linked to the fact that the emphasis on reducing labour cost remains the dominant economic prescription regarding employment creation in Europe. Institutions like the OECD and the European Commission regularly recommend suppressing tax loopholes but reducing "the tax wedge on labour", which implies to maintain the tax expenditures on wages.

- Another sector of inquiry should be the sectors where private vested interests are constituted. We make the hypotheses that the use of tax expenditures as an adjustment variable is more likely to happen where the "discreet" characteristics of the instrument applies, that is to say where constituencies are not formed and cannot be mobilized to lobby against the cuts. For example, the French personal services sector is now equipped

with powerful lobbies; they were able to negotiate important compensations when the governments decided to reform the tax credits benefiting them.

Conclusion

The rise of a discreet instrument: causes and consequences

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Annex

We selected the books that were used to conduct the keyword search among classics of welfare state and welfare reform studies. We limited our search to books published after 1990. In order to avoid geographical biases, we deliberately focused on generalist books (i.e., not specialized in any geographical areas). Yet, taking into account an expected over-representation of US reforms in the literature among reforms associated with our keywords (since most of the existing scholarship on the subject is American, and looks at the American welfare state), we added some books dedicated to specific European geographical areas. The distribution of books is as follow:

Generalist books	26
Books on continental countries	4
Books on Nordic countries	5
Books on Eastern Europe countries	1
Books on Southern Europe countries	1

List of key words (we systematically looked for plural as well):

- Exemption
- Fiscal welfare
- Tax allowance
- Tax benefit
- Tax break
- Tax concession
- Tax credit
- Tax cut
- Tax deduction
- Tax expenditure
- Tax incentive
- Tax loophole
- Tax reduction
- Tax rebate
- Tax relief
- Tax subsidy
- Tax advantage

List of the 23 books analysed

1. Anttonnen Anneli (2012), *Welfare State, Universalism and Diversity*, Edward Elgar Publishing.
2. Hemerijck Anton (ed) (2013), *Changing Welfare States*, Amsterdam University Press.

3. Palier Bruno (ed)(2010), *A long goodbye to Bismarck: the politics of welfare reform in Continental Europe*, Amsterdam University Press.
4. Ebinghaus Bernard and Philip Manow (2001), *Comparing Welfare Capitalism: Social Policy and Political Economy in Europe, Japan and the USA*, Routledge.
5. Arndt Christopher (2013), *The Electoral Consequences of Third Way Welfare State Reforms,* Amsterdam University Press.
6. Mayes David, Anna Michalski (2013), *The Changing Welfare State in Europe: The Implications for Democracy*, Edward Elgar Publishing.
7. Huber Evelyn and John Stephens (2001), *Development and crisis in the welfare state; parties and policies in global markets*, The University of Chicago Press.
8. Emmenegger Patrick, Haüsermann Silja, Palier Bruno, Seileeb-Kaiser Martin (2012), *The age of dualization. The changing face of inequality in deindustrializing societies*, Oxford University Press.
9. Castles Francis, Stephen Leibfried, Jane Lewis, Herbert Obinger, Christopher Pierson (2010), *The Oxford Handbook of the Welfare State,* Oxford University Press.
10. Bonoli Giuliano, Klaus Armingeon (2006), *The Politics of Post-industrial Welfare States: Adapting post-war social policies to new social risks*, London/New York : Routledge
11. Esping-Andersen Gösta (1996), *Welfare States in transition: National Adapatations in Global Economics*, Sage Publications LTD.
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13. Schustereder Ingmar J. (2009), *Welfare State Change in Leading OECD countries: the influence of Post-industrial and Global Economic Development*, Springer.
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15. van Kersbergen Kees (2013), *Comparative welfare state politics: developments, opportunities and reform*, Cambridge University Press.
16. Ferrera Maurizio (2004), *Welfare State Reform in Southern Europe: Fighting Poverty and Social Exclusion in Greece, Italy, Spain and Portugal*, Routledge.
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19. Kildal Nanna, Stein Kuhnle (2005), *Normative Foundations of the Welfare State: the Nordic Experience*, Routledge.
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21. Pierson Paul (2001), *The New Politics of the Welfare State*, Oxford University Press.
22. Silja Haüsermann (2010), *The Politics of Welfare State Reform in Continental Europe: Modernization in Hard Times*, Cambridge University Press.
23. Kuhnle Stein (2000), *Survival of the European Welfare State*, Routledge.

<u>List of the 2 books which showed no relevant results:</u>

1. Cook Linda J. (2007), *Post-communist Welfare States, reform politics in Russia and Eastern Europe*, Cornell University Press.
2. Kettunen Pauli, Klaus Petersen (2011), *Beyond Welfare State Models: Transnational Historical Perspectives on Social Policy*, Edward Elgar Publishing.

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2. Clarke John (2004), *Changing Welfare,Changing State: New directions in Social Policy*, Sage Publications LTD.
3. Dingledey Irene, Heinz Rothgang (2009), *Governance of Welfare State Reform: a Cross-national and Cross sectoral comparisons of Policy and Politics*, Edward Elgar Publishing.
4. Ebinghaus Bernard (2011), *The varieties of pension governance: pension privatization in Europe*, Oxford University Press.
5. Esping-Andersen Gösta (1990), *Three worlds of welfare capitalism*, Cambridge, UK: Polity Press.
6. Harslof Ivan, Rickars Ulmestig (2013), *Changing Social Risks and Social Policy Responses in the Nordic Welfare States*, Palgrave Macmillan.
7. Lehmbruch Gehrard, Frans van Waarden (2003), *Renegotiating the Welfare State: Flexible Adjustment through Corporatist Concertation*, Routledge.
8. Mishra Ramesh (1999), *Globalization and the Welfare State*, Edward Elgar Publishing.
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10. Pierson Christopher (1998), *Beyond the welfare state? The New political economy of welfare*, Polity Press.
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12. Taylor-Gooby Peter (2005), *Ideas and Welfare State Reform in Western Europe*, Palgrave Macmillan.