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How should government benefits, such as family assistance, be distributed? Targeting, or concentrating benefits on those in need, is an attractive and widely supported idea.

> However, although politically fashionable, calls for greater targeting [of family benefits] need to be treated with caution. The argument in favor has to be made explicit and critically examined. Behind such policy recommendations lie views with regard to (a) the objectives of policy, (b) the range of instruments available to attain those objectives, and (c) the constraints under which policy has to operate... (223-224)

This chapter examines the ambiguities and limitations of common approaches to targeting of benefits, and suggests the need to consider other objectives in designing effective social security programs. (Note that the author, focusing primarily on Britain and Europe, uses "social security" as a generic term for a range of benefit programs, not a specific reference to the American retirement program.)

Targeting and the Objectives of Social Security

Although social security is often linked to poverty alleviation, it has other important functions as well. These include: smoothing of income over the life cycle; provision of security against events such as sickness, disability, and unemployment; redistribution toward those with children; and redistribution according to gender or other social criteria. Relief of poverty is only one motive for the introduction of transfer payments, and sometimes not the most important one. In France, social insurance and family allowances, introduced in the 1930s, were intended to create solidarity among different groups of workers and families, not to combat poverty. Universal benefits are more politically popular, and hence may be better funded, than means-tested programs serving only a minority. Nonetheless, poverty alleviation is an important goal of social security, and the remainder of the discussion here concerns the targeting of benefits to help the poor.

Alleviation of poverty can be taken to mean raising people up to the "poverty line," a specified income level. The extent of poverty is often measured by the headcount ratio, or proportion of families with incomes below the poverty line. However, this is not the ideal measure. A focus on the headcount ratio alone has the perverse implication that the most cost-effective way to reduce poverty is to provide benefits exclusively to those just below the poverty line, since relatively small income supplements will move them above the line; the same total expenditure directed to the poorest of the poor would achieve a much smaller headcount reduction.

To avoid such paradoxes, it is more appropriate to use a measure such as the poverty gap – the total income needed to raise the poor up to the poverty line. The effectiveness of an income transfer program can then be measured in two ways: horizontal efficiency, or the percentage of the poverty gap that is filled by the program; and vertical efficiency, or the percentage of program benefits that go toward closing the poverty gap. Vertical efficiency can be less than 100 percent both because some benefits may go to non-poor households, and because the program may lift some formerly poor people significantly above the poverty line.

The two standards of efficiency measure very different dimensions of programs. At one extreme, Belgium's total social security spending in the 1970s had a horizontal efficiency of 99 percent and a vertical efficiency of 8 percent. That is, government social spending essentially closed the nation's poverty gap, but only about one-twelfth of the total expenditure went for this purpose. At the other extreme, a small means-tested program may have a vertical efficiency of 100 percent, if only those below the poverty line are eligible, but a horizontal efficiency close to zero, if the poverty gap is much larger than the program budget.

Although the poverty gap is an improvement over the headcount ratio, it still may not be the correct measure for some purposes. The definition of the poverty gap places an equal value on every dollar of income needed by everyone below the poverty line, while one might believe that there is a greater urgency in providing an additional dollar to the poorest households than to those closer to the poverty line. To reflect this concern, a spectrum of measures akin to the poverty gap can be created, by calculating each poor household's extent of poverty as

$$(\text{the poverty line - the household's income})^{\alpha}$$

and then summing or averaging across households. With $\alpha = 0$, this is just the headcount; with $\alpha = 1$ it is the poverty gap. With $\alpha > 1$, the new poverty measure weights the experience of poorer households more heavily; as α becomes infinite, it approaches a Rawlsian concern with the status of society's least fortunate individual. Academic research has often used $\alpha = 2$.

The greater the value of α, the more that the optimal policy tilts toward benefits targeted to the very poor. Many different standards can be created with this simple apparatus; for example, to reflect a moderate social value of payments to near-poor households and a greater value of payments to the very poor, one can raise the poverty line, while using $\alpha > 1$. Clearly, each variant on the measure of poverty may imply a different optimal policy response. Without a clear agreement about the appropriate measure, it is impossible to say that one program design is more or less efficient than another in alleviating poverty.

Categorical Conditions and Family Benefits

Family benefits, which exist throughout Europe and in Canada and Australia, are a prime example of categorical programs: benefits are provided to everyone in a certain category, defined on a basis other than income. Categorical programs are often criticized as inefficient, since a means-tested program with the same budget would be more efficient in reducing poverty. In practice, however, families with children, especially single mothers with children, include a disproportionate number of the poor, particularly in the U.S. but also in other countries. Thus categorical programs for this group may be reasonably effective in targeting the poor.

There are many dimensions and variations to family benefits. Some programs are tied to labor market status, such as parental leave at birth, or child care subsidies for working parents. Child benefits may vary with the child's age; several European countries provide larger benefits for older children, while others give more to parents of younger children, and a third group has the same benefit for all ages of children. Several countries that have worried about low birth rates have larger benefits per child for bigger families, while others have constant benefits per child, and the United Kingdom, in the 1990s, provides less per child for bigger families. Benefits end at ages ranging from 14 to 18, and in some countries can be extended for those in school or apprenticeship.

Categorical programs are not simply alternatives to income testing. Several European countries reduce or eliminate child benefits at high incomes. The reduction of benefits occurs more abruptly in some countries than others: a means-tested component of Britain's child benefits offers fairly high payments to the lowest-income families, but tapers off rapidly as income rises; a comparable French program offers a constant payment for all families (less than Britain pays to the poorest), up to well above average earnings.

Problems in Targeting: Information and Incentives

The ability of targeted programs to reach the poor is limited by administrative problems and by their impact on economic incentives. Administratively, any categorical or income-tested program requires information about potential recipients; gathering and verifying this information can be expensive and difficult. Errors are possible in both directions, as eligible households may fail to get benefits while ineligible households may succeed.

When eligibility depends on something as simple as the presence of children in the household, errors may be relatively rare and administrative costs may be low (though not zero). For income-tested transfers, information requirements, administrative costs, and potential for error are all much higher. The stigma attached to participation in such programs, and the demeaning and tedious nature of the application process, often lead to a third or more of the eligible population failing to claim their benefits.

Income-tested programs also create problems of work incentives. If a household loses benefits as its wages begin to rise, the effective tax rate on its earnings may be high enough to discourage work effort – falling into the "poverty trap." In the United Kingdom in 1992-93, the marginal income tax rate on low-income wage earners was 34 percent. However, those who qualified for three major means-tested social programs also faced the loss of those benefits, adding up to an effective tax rate of 96 percent on incremental earnings. Concern about such high effective taxation may arise both from its impact on labor supply, and separately from a sense of fairness: it may be regarded as unfair that a person is unable to improve his or her position by working more. These concerns may lead to limits on the extent to which benefits can be means-tested, and therefore limits on targeting of payments exclusively to the poor.