The Government Giveth, and the Government Taketh Away

Tax-welfare Churning and the Case for Welfare State Opt-Outs

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ABBREVIATIONS USED IN THIS BOOK

EMTR Effective Marginal Tax Rate (the amount lost from the next dollar earned as a result of tax paid and withdrawal of means-tested benefits)
FTB Family Tax Benefit (paid to families to help with the cost of raising children)
GMI Guaranteed Minimum Income (a basic income paid by government to all adults as of right)
MSA Medical Savings Account (a personal savings account dedicated to payment of specified health costs)
NIT Negative Income Tax (a government payment to supplement income, based on a set rate per dollar below a given threshold)
OECD Organisation of Economic Cooperation and Development (the world's richest countries)
PBS Pharmaceutical Benefits Scheme (government subsidy to reduce the cost of specified drugs)
PFF Personal Future Fund (a proposed individual savings fund)
SG Superannuation Guarantee (compulsory contribution into a personal retirement fund, currently paid by employers)
TFT Tax-Free Threshold (income level at which tax starts to be payable)
WfD Work for the Dole (a government scheme linking receipt of unemployment benefit to a work activity)

CHAPTER ONE: HOW DID WE GET INTO THIS MESS?

When I was a little advanced into the island, I saw an old man who appeared very weak and feeble. He sat upon the bank of a stream [and] made a sign for me to take him upon my back and carry him over the brook, signifying that it was to gather fruit. I believed him really to stand in need of my help, so took him upon my back, and having carried him over, bade him get down, and for that end stooped that he might get off with ease: but instead of that, the old man, who to me had appeared very decrepit, clasped his legs nimbly about my neck... He never left me all day, and when I lay down to rest by night, he laid himself down with me, always holding fast about my neck. Every morning he pushed me to make me wake, and afterwards obliged me to get up and walk, and pressed me with his feet. You may judge then what trouble I was in, to be loaded with such a burden as I could by no means rid myself of.

'The Fifth Voyage of Sinbad the Sailor' (Tails of the Arabian Nights)[1]

In the beginning…

In the early nineteenth century, the role of government was limited to three core functions. It waged war and defended the country's borders against attack by other nations; it maintained domestic order through a system of criminal and civil law; and it enabled citizens to trade and interact with each other by building roads, issuing a common currency and regulating and enforcing voluntary contractual agreements. Beyond that, it did very little, and very little more was expected of it.

During the course of the nineteenth century, however, governments got busier. In particular, they started to get involved in organising people's education and general welfare. In both England and Australia, these were traditionally tasks that had been left mainly to the churches, charities and private philanthropists. Private individuals and voluntary organisations had long played an important role in the relief of poverty and the provision of schooling for the children of the labouring classes, but gradually their functions were taken over by municipal authorities which levied rates to fund poorhouses for the destitute and which built and ran elementary schools.

By today's standards, of course, government budgets locally as well as nationally remained very small. Taxes stayed low (ordinary working people did not start to pay income tax until well into the twentieth century) and demands on government spending were kept in check. People had not yet become habituated to looking to politicians to solve their problems for them, and the institutions of government hardly intruded on the everyday lives of ordinary, law-abiding working people.

Over the next hundred years, all this was to change. As the twentieth century unfolded, governments at all levels came to play an increasingly dominant role in the lives of all Australians. The reason was that, having once picked up the responsibility for looking after people's welfare, politicians found that in a democratic age, it was impossible to limit it. There were so many problems, so many good causes justifying the additional use of public funds, and so many votes to be won by dispensing money

to people who needed help. Gradually, governments stepped in to support elderly people who could no longer work, widows left penniless by the death of a husband, workers left idle by the collapse of the job market, people struck down by disease or disability, families struggling to raise children.

But where do you stop? Having decided to help one group, governments found it increasingly difficult to resist the claims of others further back in the queue. The more they did to try to support those in need, the more needy the population seemed to become. The more they spent, the more the demands for higher spending escalated. Like Sinbad and the Old Man of the Sea, politicians discovered that having picked up the burden of responsibility, it was impossible to relinquish it.

Fast forward to today. Now it is not just the poor, nor even the 'labouring classes', who have come to rely on government assistance. Nowadays, almost everybody has their hand out, and few go away disappointed. If it isn't middle class parents getting family payments, it's affluent patients claiming Medicare refunds or able-bodied youngsters applying for unemployment benefits, or dual-earner households demanding child care subsidies. At some point over the last hundred years, we grew into a nation of supplicants without even realising it.

How churning disempowers people

As government spending has spiralled upwards, we have learned to take the extended role of government for-granted. We rarely stop to ask why we need to rely so heavily on politicians to provide for us when we are so much more affluent than earlier generations were. Nor do we apparently find it disturbing that government now absorbs one-third of all the wealth we create each year, and that the trend towards ever-increasing government expenditure shows no sign of weakening. Indeed, we have become so habituated to omnipresent government that our first instinct whenever we become aware of a problem, be it the cost of raising children, the price of the latest miracle drugs, or the expense of looking after the elderly, is to turn to politicians and demand that they step up their level of spending.

Far from being battles for hearts and minds, election campaigns in the era of big government have become little more than set-piece occasions where governments and opposition parties compete to offer us more goodies. Listen to radio phone-ins at Budget time. It is clear that Canberra is seen by many voters as a giant cash machine whose principal purpose is to spray money at them. Read the press releases of the pressure groups lining up during election campaigns to complain that their members have been overlooked or that others are being unfairly rewarded. Look at the newspaper editorials calling for more hand-outs for families with children, elderly people, working mothers, university students, pre-school toddlers. In the lead-up to a federal election, our democracy looks less like the Athenian *polis* and more like a bunch of spoiled children squabbling over their presents on Christmas Day morning.

Rarely does anybody step back from this political scrummage to reflect on the fact that the government doesn't actually have any money of its own to dispense. Every dollar directed at one section of the population has to be taken from another. So as the demands and expectations escalate, governments find themselves robbing Peter to pay Paul and then mugging Paul to compensate Peter. They tax the working mums to pay

pensions to the elderly, and then they tax the elderly to pay for the increased child care subsidies demanded by the working mums. The net result of all this cross-subsidisation is that many of us end up no better off than we would have been had the government left us alone in the first place. What we receive in benefits, subsidies and direct services we lose in higher taxes. Everybody is paying for everybody else's hand-outs, but few of us seem to be aware of it.

The people who gain from all this churning of taxpayers' money are the politicians, for provided the voters do not tumble to what is going on, they can continue to curry favour and win support by bribing different sections of the electorate with their own money. Tax churning empowers political leaders for it puts our cash in their hands. It also enriches bureaucratic managers in the public service whose status and salaries inflate with each new government spending programme they are given to run.

But most other people lose. It's not just that tax churning is expensive (we never get back the full value of what we pay in, for government bureaucracies cream off a percentage to cover their own running expenses). More importantly, we lose because tax churning disempowers us. When we hand over our money to the government, we relinquish our ability to make our own decisions and choices about how it should be spent. From then on, governments make these decisions for us, and we have to accept what they decide to provide for us—the schools they think our children should attend, the retirement pension they think is appropriate for us, the hospitals they think are good enough to provide the treatment we need. Like children, we are rendered dependent on a higher authority to determine many of the most important decisions affecting our lives.

How did we allow ourselves to get locked into this craven relationship with our own government? How did we get reduced to the role of grateful recipients of our own cash? Whatever happened to our proud ideals of self-reliance? How did we become so convinced of our need to rely on politicians for hand-outs when earlier generations (who lived in a world incomparably less affluent than our own) were perfectly happy running their own lives with little support from the State?

The growth of government and the mass welfare state

If you work, you pay tax on your earnings. If you buy something out of what is left in your wage packet you pay tax again on your purchases. Try saving and you'll pay tax on the interest; invest your money and you will pay tax on the profits.

Your taxes are required to pay for government schools, even if your children don't use them, for government health insurance, even if you prefer to pay privately for your own health care, and for government age pensions, even if you have put adequate savings aside for your own retirement. You are also forced to pay taxes to help people you may or may not consider deserving of your support. You are required to provide incomes for jobless people you do not know, to support the stay-at-home lifestyle of single parents who are strangers to you, and to contribute to the costs of raising other people's children to whom you are not related. If you have the temerity to question any of this, you risk getting berated for being 'selfish,' or even 'unAustralian.' Most people just shut up and pay up.

How did we allow ourselves to get dragged so far down this interventionist road and to abdicate so much control over our own money? A large part of the answer is that we created a welfare state.

The biggest single driver of the expanded role of government has been the growth of the welfare state. The main business of government has shifted over the last hundred years from the traditional priorities of defence and law and order into the new and insatiable task of providing for other people's needs. If it were not for the modern welfare state, government would be at most a third of its current size.

Table 1.1 shows that the Commonwealth government now spends over $200 billion of our money every year. The lion's share of this goes on the three principal pillars of the modern welfare state—education, health and income support. Much of the $40 billion spent by the states and territories each year also goes on the welfare state—principally public schools, which are a state responsibility, but also things like public housing and community services.

Table 1.1: Breakdown of estimated federal government expenditure, 2005-6 ($billions)[2]

Welfare State		141.9 (69%)
Education	15.6	
Health	37.6	
Social security & welfare	86.4	
Housing & community	2.3	
All Other services		64.1 (31%)
Defence	15.8	
Public order & safety	2.8	
Transport & Communications	3.1	
Fuel & energy	4.0	
Agriculture, mining, etc	4.3	
Other economic affairs	5.1	
Government expenses (research, super, foreign affairs)	13.0	
Other purposes	13.3	
Total		206.0

Because most of us have grown up taking the welfare state for granted, we tend to assume that things like government pensions, state schools and Medicare are essential components of a 'civilised' society. People obviously need retirement incomes, schooling, health care, so it seems only right that government should be spending billions of dollars providing us with these things. Indeed, every day the newspapers discover some new 'need' that demands the government's attention. How could anyone suggest that 'public expenditure' (that is, government expenditure) should be reduced rather than expanded?

The thought of radically cutting back on government strikes us as unrealistic, if not gratuitously uncompassionate. Surely 'we' must spend more on child care if working parents are reporting shortages of adequate places? How can 'we' not spend more on youth training when we know the demand for unskilled labour is falling? Isn't it hugely irresponsible to propose cuts in government spending when there are so many worthy causes crying out for more funding?

We have become locked into a welfare state mindset which assumes that any problem and any need has to be resolved by government. This is why many Australians think the government should levy even higher taxes and spend even more money on an apparently endless list of deserving causes.[3] Because they assume that government is the sole agency capable of meeting people's everyday needs, the idea of winding back the welfare state appears heartless. The idea has taken root that if you care about other people, you have to support high taxes; that to demonstrate compassion, you must acquiesce in grotesque levels of government spending.

The possibility that things might be done some other way is rarely considered. The notion that many of the people currently being 'helped' by the government could actually care perfectly well for themselves if only the government would leave them alone rarely surfaces. We have grown up assuming that if there is a problem, only the government can do anything about it, and once implanted in our brains, this is an assumption which is remarkably difficult to dislodge.

Not even the collapse of socialism and the enormous economic success of free market reforms over the last twenty years has shaken our ultimate faith in the beneficence and necessity of big government. We are today subject to 1,800 Commonwealth Acts of Parliament. One hundred pages of new law are created by federal politicians every day Parliament sits. The number of Commonwealth public servants has increased by a fifth since 1999.[4]

All of this interference in our lives costs money. Since 1965, the share of the country's GDP absorbed by taxation has increased by more than a quarter of a percentage point every year. This may not sound much, but per capita GDP has itself been growing steadily during this period, so the government has been taking an ever-rising share of an ever-expanding cake. The result is that *the average amount of tax paid by each Australian each year has grown by 200 percent in real terms in just forty years*.[5]

If the trends of the last forty years were to be repeated in the next forty, we could end up by the middle of this century with one quarter of working-age adults living wholly on government hand-outs while the rest of us struggle to pay the costs of a government system absorbing getting on for half of everything the country produces. The prospect of a dwindling number of taxpayers supporting an increasingly inadequate and creaking system of government schools, government health care and government pensions and welfare hand-outs is staring us in the face, but nobody is thinking seriously about how to avoid it. We are so in thrall to the idea of big government that we can't bring ourselves to imagine a life where we provide these things for ourselves.

Yet it was not that long ago that most Australians routinely provided most things they needed for themselves without looking to the government to provide for them. For our forebears, the idea of relying on the government to give them an income if they were not working, or to pay for their medical bills if they fell sick, would have seemed extraordinary. They would have regarded these things in the same way that we might react to the government offering to provide us with our groceries.

The central irony of the growth of the welfare state over the last hundred years is that government has taken on more and more responsibilities precisely as people's ability to fend for themselves has been increasing. The less we have needed the government, the more it has provided, and the more it has provided, the more we have learned to depend upon it rather than making our own arrangements.

While it may once have been necessary for the government to provide the mass of the population with schooling, health care, age pensions, and other necessities of life, this is not necessary now. The economy has expanded several times over, and people's real incomes are dramatically greater today than they were one hundred years ago. The mass Australian welfare state has come to fruition precisely at the moment when it has outlived its usefulness. Rather than clinging on to it, we should be reforming it, and we should do it before it suffocates the life out of us.

The 'help' we no longer need

The basic message of this book is that we live in an age when most people could afford to buy most or all of the services they need if only they were not taxed so highly to pay for the services the government wants them to have. We shall see in the chapters that follow that most of us are already paying in taxes for much or all of what the government 'gives' us in services and cash payments. It could hardly be otherwise, for on average, the welfare state costs every person in the country seven or eight thousand dollars per year, and there are simply not enough rich people to cover this. When you consume another 'free' government service, you pay for it with another tax increase.

Given our level of affluence today, the welfare state has become an anachronism.[6] If it had not been bequeathed to us, we would never invent it today. Rather, we would concentrate on keeping personal taxes low so that people can afford to make provision for their own needs out of their own earnings. We would encourage people to save for retirement in their own superannuation funds; to insure themselves against ill-health; and to put money aside to guard against unemployment and other risks. We would not see the point in paying a government middle man to provide these things for us when we were perfectly competent to take responsibility for them ourselves.

The political reality, however, is that we are saddled with a very expensive welfare state which it will be difficult to dislodge. We have grown accustomed to paying taxes in return for government services and benefits, rather than using our own money to make provision for ourselves and our families, so restoring the habit of self-reliance will not be easy. When thinking about welfare reform we are not starting from scratch, and we do not have the luxury of drawing up ideal blueprints about how services like retirement pensions, health care and education might best be organised.

We have to think about the future development of the welfare state from the point we have already reached.

Any argument for a radical departure from current practice has to convincingly answer three core questions:

- Is there a practical and feasible alternative to the existing system? If so,
- Would the proposed new system be better than the one we have now? If so,
- How would the new system work?

This book sets out to answer these three questions. Chapter two asks whether it is possible to replace the existing welfare state in Australia while ensuring that people can still meet their basic needs. Chapter three asks why it is worth making such a change. Chapter four looks at various proposals that have been put forward for reducing people's dependency on government without exposing them to unacceptable hardship or risk. And chapter five sketches out a reform package for Australia, based on tax reductions and voluntary welfare state opt-outs, which could attract widespread support without unsettling those who have become wedded to the idea that the government knows best how to look after them.

CHAPTER TWO: THE WELFARE STATE WE NO LONGER NEED

> *"After World War II, in a few countries, wealth increased so much that, for the first time in human history, there was enough money to go around. It was technically possible for no one to be poor"*
>
> Charles Murray, 'In Our Hands' (2006)[7]

For most of Australia's history, working-age people have expected to look after themselves and to care for their families from their own resources. Those who for one reason or another could not cope or who needed extra help in times of trouble relied on aid from their families, churches, charities, or from prosperous philanthropists who wanted to 'put something back' into their communities by building a hospital or founding a school.

The generally-held assumption that able-bodied men of working age could and should look after themselves and their families without seeking support from others underpinned the establishment of the wage fixing system in the early years of the 20th century, when it was determined that a working man should receive a wage sufficient to pay for the needs of a wife and three children without relying on outside help and support. The community norm was family self-reliance, and people were proud of their independence.

Self-reliance was expressed in a number of ways. One was the emphasis on home ownership—the mud-brick house on a quarter-acre block. For the middle classes, it also meant saving to pay school fees and to provide an income in old age, but less prosperous working families generally found private schools, medicine and pensions beyond their means in the 19th century. The churches and charities offered the poorest some help, and medical professionals would sometimes offer their services to the poor for free,[8] but workers in better-paid or more secure occupations increasingly achieved self-reliance by pooling their purchasing power through friendly societies and other mutual organisations which could offer benefits or insurance in return for membership.

The friendly societies typically offered members and their families medical benefits (general practitioner services and hospital cover), together with sick pay and death benefits, in return for regular payments of a few pennies a week. By the start of World War I—the high-point of the Australian friendly societies—almost half of Australians were covered by such benefits.[9] But membership of mutual aid organisations required a regular income, and a substantial chunk of the population was still left without secure cover. At periods of high unemployment, such as the 1890s, this resulted in significant levels of hardship in the population.

Government was not entirely absent from everyday life in the 19th and early 20th centuries. Public elementary schooling was provided in all states with compulsory attendance up to the age of 13, although attendance was not always enforced, and compulsion did not apply to indigenous children.[10] 'Relief work' modelled on the English Poor Law was also available in all states for those who qualified for it.[11] But for the most part, families expected to look after their own needs and requirements. In

a period when the society was much less affluent than it is today, and when average real wages were much lower, a majority of the population nevertheless expected to provide for its own needs with little resort to government.

This limited role for government was reflected in tax levels. There was no income tax in any state of Australia before 1880, and there was no federal income tax prior to 1915. Even when income taxes were introduced they did not touch most of the population. Up until the First World War, government spending at national and state levels remained remarkably low by today's standards, so the tax take from all sources stayed low too.

Each year the Centre for Independent Studies calculates the date of 'Tax Freedom Day.' This is the exact point in the year when the country has generated enough wealth to cover government's spending, so that people can start to earn money for their own use. One hundred years ago Tax Freedom Day fell on January 24th. In 2006, it fell on April 25th.

The great 20th century perpetual motion welfare machine

The standard of living a century ago was not high enough to enable those on low incomes or in intermittent employment to save and insure adequately. To the extent that people needed help in funding their old age, insuring against unemployment or paying medical bills, the coming of the welfare state met a real need.

There was, for example, a pressing need to help the destitute elderly. Relatively few working people lived long past retirement age, but those who did had few savings or assets. They often had little option but to live out their lives in hospitals, for there was no other provision made for them. Following federation, the new Commonwealth Government introduced means-tested age and invalid pensions so people of 'good character' could maintain themselves at a basic but adequate standard. This established a pattern of means-tested, non-contributory cash benefits which was extended to other sections of the population several decades later.

In the 1940s, Commonwealth widows' pensions, unemployment benefits and a Child Endowment were introduced,[12] and in the 1950s the Commonwealth began to make a contribution to people's medical fees. Even at this stage, however, reliance on government welfare provisions was still limited. As late as the mid-1960s, only 3% of working-age adults relied mainly or wholly on welfare benefits for their income, and before Medicare was introduced in 1982, nearly three-quarters of families had their own private health insurance cover.[13]

It was from the 1970s onwards that dependence on government welfare services and cash payments started to rise significantly. From then on, the mass, bureaucratic and increasingly costly welfare state that we know today started to consume tax revenues at an increasing rate. Expansion of the income support system since the 1970s has led to 16% of working-age adults relying on welfare benefits for most or all of their income (an increase of more than 500% in less than 40 years). And with the creation of Medicare, state and federal governments now pay for almost three-quarters of all health expenditure, as a result of which private health insurance coverage has fallen to 40% of the population.

This expansion of the welfare state has occurred at precisely the time when the need for government to support us has been falling away. The irony of the history of the welfare state in Australia is that it has expanded in inverse proportion to the need for it.

Economic growth since World War II has transformed living standards, and improved economic management has reduced the threat of severe depressions and mass unemployment. In the 1970s, when the welfare state began its huge expansion, the economy was growing at an average of 2% per annum, raising national wealth by a quarter. Following the economic reforms of the Hawke/Keating years, economic growth increased to 3.5% per annum, lifting national wealth by another 40%, and in the last ten years the economy has been growing at an annual rate of 4%, increasing the national wealth by half. This sustained period of growth has meant real per capita incomes have more than doubled since the 1960s.[14] As recently as 1989-90, Australians had an average real income of $25,865. By 1999-2000, this had grown to $32,605 in constant prices, an increase in living standards of nearly 24% in just 10 years.[15] Rates of growth this high mean that goods and services that our grandparents could never have afforded are now potentially well within the budget of most ordinary people.

Writing about Britain, Labour MP Frank Field notes: ‘For the first time a sizeable part of the working class and lower middle class now have incomes that give them real choices’.[16] The same is true in Australia. Inherently expensive items like personal pensions, medical insurance, unemployment insurance, even schooling, are now potentially affordable to people who could never have acquired such things for themselves just two or three generations earlier.

Yet at precisely the point where the need for extensive government help and provision has been receding, the welfare state has been expanding. In a period when real incomes have doubled, dependency on government cash hand-outs has gone up five-fold and the number of people taking financial responsibility for their own health insurance needs has been halved. The welfare state is like a machine that was set running 100 years ago to meet a requirement that is no longer there. This machine been speeding up ever since, and nobody seems to know anymore what it is there for, or how to switch it off.[17]

Where the money goes

The welfare state delivers support for people’s living standards in two different ways. In some cases it gives people cash. In others, it provides them with services.

1. Cash transfers

The welfare state allocates cash to people it defines as being ‘in need’. In Australia, these transfer payments (called ‘income support’ payments) take many forms,[18] but there are five key ones.

The first four are the age pension (for retired people), unemployment benefits (consisting of Newstart for mature workers and Youth Allowance for younger

workers), the Disability Support Pension (for those deemed too incapacitated to work) and Parenting Payments (providing an income for jobless or low income single parents, and for jobless parents living with unemployed partners). All four of these payments are means-tested, which means you only get the money if you have little or no income from other sources. All four are also financed directly out of taxation, so unlike their counterparts in most other developed countries, recipients do not have to establish any entitlement to government payments by contributing first to a social security fund.

The fifth payment, Family Tax Benefit (FTB), is given to families to help with the costs of raising dependent children. It is divided into two parts. FTB Part A is means tested on the whole family income. Despite this, about nine in every ten families receive something. FTB Part B is an additional amount paid to single parent families and to couple families where there is only one main earner. It is not means tested (so as countless critics have pointed out, millionaires' wives still qualify). FTB can be claimed as a fortnightly cash payment or credited against tax at the end of the fiscal year. Government leaders like to describe it as a tax reduction rather than as welfare expenditure, but for 90% of recipients it is taken as a cash hand-out, and it is best understood as the fifth major component of the income support system.[19]

Table 2.1: Estimated welfare state spending, Commonwealth plus States and Territories, 2004-05 ($billion)[20]

Over the last 30 years or so, government spending on cash transfer payments has increased through bad times and good, under right-wing as well as left-wing governments. Since the Howard government came to office, the Australian economy has been booming, real wages have been rising strongly, labour force participation rates have been rising and unemployment has fallen to its lowest level in 30 years. Yet

despite all this, the biggest single increase in federal government spending since 1996 has been on income support payments, up from 41 to 44% of the Commonwealth budget.[21]

2. Services in kind

Table 2.1 shows that, taken together, the income support payments system accounts for about 45 per cent of total welfare state expenditure. The remainder is accounted for by services in kind, of which the main ones are health and education.

Unlike means-tested income support payments, most government services are provided on a universal basis (that is, they are made available to all eligible people irrespective of their financial circumstances). However, charges are sometimes levied (for example, Medicare co-payments and HECS fees in higher education) and higher income earners are sometimes charged more (for example, a Medicare levy surcharge is imposed on higher rate taxpayers if they do not have private health insurance). As with income support, so too with welfare state services, access is not limited to those who have made financial contributions, but is regarded as a right of citizenship.

Who pays for the welfare state?

The welfare state cost Australians $182 billion in 2004-05 (Table 2.1). This was by far the biggest category of government expenditure. Federal and state government together raised about $260 billion in tax that year (Table 2.2). Seventy cents in every dollar of tax paid from all sources thus got spent on welfare benefits and services

Table 2.2: Tax revenues (all levels of government) 2004-05[22]

Where did all this money come from? The answer, for the most part, is that it came from the same people as the money was spent on.

It should be remembered, of course, that virtually all the tax revenue raised by federal and state governments comes ultimately from the pockets of individual citizens. Many people are unaware of this. They think 'big business' or rich property owners can be tapped for revenues without any knock-on effects on people like themselves. They are wrong.

The source of government revenues is obvious and transparent in the case of personal income tax, for this is taken directly out of the money we earn. It is less obvious when we pay indirect taxes such as GST, for here tax gets rolled up into the total purchase price of the goods and services we buy, and it is handed to the government by businesses (which function as unpaid revenue collectors) rather than by individual consumers. But it is of course the latter who ultimately pay it.

The ultimate payer is even more opaque in the case of company taxes such as taxes on profits, special levies on particular industries, and tariffs on imports. Here it seems that 'business' is paying, yet again it turns out that ordinary individuals are actually picking up the tab. This is because these taxes are covered by the price of the goods and services we buy—if company taxation goes up, so does the price we pay for the goods that companies sell to us.[23]

Money thus pours into the government from many different sources, but ultimately it nearly all comes out of the pockets of individual citizens. These are the same individual citizens who are also the principal recipients of the government's welfare spending. Thus, while we rely on the welfare state to provide us with health care, schooling or a retirement income, we finance these payments and services through the direct and indirect taxes and charges we pay. What we receive with one hand, we pay for with the other.

Looked at in this way, ordinary people are still paying for most of their own welfare services, just as they did one hundred years ago. The crucial difference is that people one hundred years ago were in control of their own money, saving for their own old age, or purchasing the benefits they wanted from the friendly society of their choice. This made for a high level of accountability on the part of service providers, for consumers could withdraw their payments if they found the service unsatisfactory. Doctors employed by friendly societies, for example, were held to account by the individual members at Lodge meetings and could find their contracts terminated if they did not come up to scratch.

Today, by contrast, we give our money to government 'middle men' who then spend it for us. Expenditure decisions in crucial areas of our lives are made for us by politicians, bureaucrats and professional 'experts' who take our money in taxes, deduct a large slice to cover their own overheads, and then return the rest in the form of the payments and services they decide to buy. This obliges us to accept what they give us rather than shopping around to find what we really want. It also means the

service providers are much less accountable to our preferences than they would be if we were contracting directly with them ourselves.

It is true that we have the opportunity every few years to vote for the people who will make these decisions on our behalf, but we have no say over how much of our money they spend or what they spend it on. We cannot decide to put more of our money into one kind of service by spending less on another, for these budgetary decisions are all determined for us by politicians, bureaucrats, and pressure groups in Canberra. If as individuals we find a particular service unsatisfactory, we cannot withdraw our patronage—all we can do is contact our elected representative and hope they can do something on our behalf. If we decide we want something different from what the government is offering, we are still required to pay for the service we do not want while paying again to get the private sector alternative we prefer.

Because we have become habituated to large government bureaucracies spending our money in this manner, we tend to assume things have to be organised this way.[24] We have forgotten that our forebears used to decide these things for themselves (even though they had much less spending power at their command than we have). We have lost the habit of making our own choices.

What about the poor?

Because we take the existence of the welfare state for granted, we tend to assume that if it disappeared, we would not be able to afford to buy the services that the government now provides for us. We forget that we are already paying for these services through our taxes. Without the welfare state, our take-home wages would be much higher (because income tax would be reduced), and the price of the goods and services we purchase would be much lower (because indirect taxes and company taxation would be reduced). We would therefore have more money left in our pockets to purchase the additional benefits and services we need without having to look to the government to support us. Furthermore, these services would almost certainly be less costly and/or higher quality than those the government currently provides.[25]

But what about the poor? Virtually everybody pays something towards the billowing costs of the modern welfare state, just as virtually everybody gets something back from it. But some people pay more in than others, and other people take more out. If this massive bureaucratic delivery system were shut down, and the money were left in our own pockets so we could decide for ourselves how to spend it, wouldn't some poorer people lose out? Don't we still need a welfare state to provide for the least fortunate?

Some people pay a lot more tax than others. Sinclair Davidson calculates that the top quarter of income earners at any one time pay nearly two-thirds of all the income tax collected by the Commonwealth government (although the burden of indirect taxation is spread less unevenly).[26] Not all of this tax goes on welfare, of course—some also helps pay for defence, police, transport and other state and federal government services[27]—so when calculating how much tax people pay for their welfare services, these other items have to be taken out of the equation. This adjustment has been made in all the calculations that follow.

Those who pay most into the system tend to take least out of it. One-third of parents choose to educate their children privately, for example, and although they benefit from government subsidies of private school fees, they lose a lot more than they gain by forfeiting their places at schools in the state sector for which they have already paid. Similarly, the 40% of families that pay for private health insurance enjoy a tax rebate on their premiums, but they end up paying a lot more for the public hospital beds they never use. Many taxpayers pay for government unemployment and disability insurance that they never draw upon, just as working couples raising children pay to support non-working single parents while supporting themselves from the post-tax income that remains.

The net result of all this differential tax payment and welfare withdrawal is that incomes get significantly redistributed within the population (Table 2.3). In 1998-99, the people on the top 20% of incomes paid for 51% of welfare state expenditure, but they withdrew only 16% of the value of the services their taxes helped provide. Those in the bottom 20% of the income distribution, by contrast, paid for only 3% of the total welfare state budget but received 21% of all the welfare state spending.

Table 2.3: Tax contributed to welfare state budget, and value of payments and services received, by different income groups (1998-99)[28]

This redistribution results in a significant compression of people's 'final incomes.' After tax has been paid and the value of welfare benefits and services has been added, the income share enjoyed by the highest 20% of earners falls from 50% to 38%, while that of the lowest 20% increases from 1% to 7%. In 1998 dollar terms, the lowest earning households had their incomes increased from zero to $391 per week as a result of tax and welfare transfers while the highest earners dropped from an average of $1,305 to $798.[29]

Most of this compression is due to the different amounts of tax people pay, not the different amounts of government services they consume. While the value of what people put into the system varies widely, it is clear from Table 2.3 that the value of the services they take out is spread much more evenly across income groups. Indeed,

the highest earners receive slightly more than their proportionate share of the value of these services (21%) while the lowest earners get somewhat less (16%).[30] Receipt of cash benefits is rather more skewed, for Australia's heavily means-tested payments system excludes the highest earners from eligibility for many income support payments. Nevertheless, even here the share absorbed by the lowest income group is only eight percentage points above its proportionate share, and much of the money that is handed out goes to households around the middle of the income distribution.

There are two key reasons for this. One is that most retired people receive an age pension, even if they are living in expensive houses and receiving retirement annuities. The other is that families with children receive FTB payments even when their household incomes are well above the average income. In 2005-06, a family with two children on average weekly earnings of $53,000 per annum paid some $12,649 in income tax, but got all of this back in family payments. Even a family on $150,000 could still qualify for over $2,000 worth of FTB and childcare subsidies.[31]

Although the money raised to fund the welfare state comes disproportionately from those with higher incomes, therefore, what remains after the bureaucracy has taken its slice is distributed fairly evenly across the population. Most of the income redistribution that takes place occurs, not as a result of how money is spent in the welfare state, but as a result of the way it is raised in the tax system.[32] One implication of this that cutting back on welfare state spending will not necessarily increase inequality. Another is that a large number of people is receiving payments or services from the government when they could be providing for themselves.

Tax-welfare churning

Because welfare benefits and services are spread right across the population, many households find themselves paying money into the system only to get it straight back again in the form of government payments and services. This is clearly demonstrated by Tables 2.4a and 2.4b.

Note that these tables are not strictly comparable. Table 2.4a is based on an Australian Bureau of Statistics survey in 1998-99. It divides the population into income quintiles based on their original, gross income, and it includes only that proportion of their total tax payments which go towards financing the welfare state. Table 2.4b, by contrast, is based on 2001-02 estimates by the National Centre for Social & Economic Modelling. It divides the population into quintiles based, not on gross income, but on disposable income (that is, after direct tax and cash benefits are taken into account), and it includes all the tax payments made by these households (irrespective of how the money gets spent), although it excludes taxes raised at state and local level. These differences in the way the tables have been compiled mean that the figures in each differ significantly. The overall pattern in each table is, however, broadly the same, and the data in each tell much the same story.

Both tables show that households with below median incomes get a lot more out of the welfare state than they pay in, while those in the top income bracket pay a lot more tax than they get back. As for households in the second and third deciles (that is, those in the middle and upper-middle income brackets), they pay substantial amounts of tax and they receive substantial amounts of welfare state benefits in return. It seems

from this that churning is concentrated in the top 60% of incomes, and is most in evidence in middle and upper-middle income households.

Table 2.4a: Average annual value (1999 dollars) of tax paid into welfare state and benefits received from welfare state by different quintiles of gross income[33]

Table 2.4b: Total annual tax payments, and value of welfare benefits and services received, by households in different quintiles of equivalent disposable income, 2001-02[34]

On their own, however, Tables 2.4a and 2.4b do not prove that the same people in each income group are paying the tax and receiving the benefits. But research by the National Centre for Social and Economic Modelling (NATSEM) shows that it often is the same people, particularly if they are families with dependent children.

Looking at tax and welfare transfers in 2001-02, NATSEM found that younger people without children generally paid more in tax than they received back in welfare, and that older people generally received more in welfare than they paid in tax. But for people in their middle years who were earning and raising a family, the activities of the tax and welfare agencies tended to cancel each other out (Table 2.5).

Couples with pre-school children (column 3 in Table 2.5), for example, paid a weekly average of $374 in income tax and GST but immediately got $292 of this back in cash or services. For all the huffing and puffing of the giant government bureaucracies which were required to process these money flows, the net result was an average adjustment to these families' total incomes of just minus 7% (an average private income of $1,095 was reduced to a final income of $1,014). Similarly, couples with

school-age children got a net top-up of just 10%, and those whose oldest child was beyond the school-leaving age had their incomes boosted by a mere 6%.

Table 2.5: Incidence of weekly tax payments and welfare receipts for different types of households, 2001-02[35]

				223.4	*102.3*	*56.1*		
Net cost/benefit	*-106.7*	*-319.7*	*-81.6*	*+114.3*	*+89.7*	*+41.1*	*+446.5*	*+295.1*
Final income	524.1	1070.9	1013.9	1274.3	1485.3	725.6	734.1	445.9

Anthony de Jasay refers to this process of taking money in tax only to give it back immediately to the same people as benefits and services as 'simultaneous churning'.[36] He suggests this comes about largely as a result of politicians trying to buy the support of different sections of the electorate. Different groups get wooed with different offers, but each new promise is paid for out of general tax revenues. The aggregate result is that we all end up paying for each other's hand-outs.

The 2004 federal election provided a clear illustration of how this works. Each time the Labor opposition floated a new spending plan aimed at some specific section of the electorate, the incumbent Liberal-National Coalition parties trumped it. In just one day during the campaign, Prime Minister Howard announced six new policies costing a total of $6 billion in new spending. They included more spending on child care (appealing to parents with young children), increased family payments (to attract families with older children), new colleges and apprenticeships (pitched at younger voters and teachers) and tax breaks for small businesses (aimed at reinforcing his support base among independent entrepreneurs). Over the whole campaign, the Howard government promised $10 billion of additional annual spending on health, education, child care, aged care and other commitments.[37]

But what people received as a result of these promises, they paid out again later. The young parents who benefited from the child care subsidies had to pay more tax to cover the help for small businesses, and the families who got higher FTB payments found themselves paying for the new apprenticeships. In order to pay more out, the government had to take more in.

Obviously, some people benefit when government spending rises, for not every tax dollar is churned back to its original owner. The NATSEM study shows that, although most couples with children pay in tax for most or all of what they receive in welfare benefits and services, those in the bottom fifth of the income distribution make substantial net gains as a result of government income transfers, for they have very little private income to start with (these are generally non-employed, welfare-dependent families).[38] This is consistent with the data in Table 2.4a (which includes all household types, not just families with children) which show that people in the bottom quintile of incomes in 1999 paid on average only $40 into the welfare system

but received $286 back.[39] Simultaneous churning is thus less marked at each end of the income distribution than it is towards the middle.

The fact that people with low or no private income still rely heavily on net tax/welfare transfers brings us back to the question of how the poor would fare if the welfare state were wound up altogether. The fact that many Australian households effectively pay for their own welfare means they should be able to get by in a post-welfare state society with little difficulty—what they would lose in government benefits they would gain in reduced taxation. But the evidence on simultaneous churning would seem to suggest that the poorest one-quarter to one-third of the population still depends heavily on the welfare state to boost its living standards and keep it out of financial hardship and deprivation. This being the case, wouldn't they lose significantly if the welfare state were wound back?

Those who need assistance today are not the same people as need it tomorrow

The answer is: not necessarily, for much poverty and hardship is transitory. Up until now we have been looking at tax-welfare money flows at just one point in time ('simultaneous churning'). We have taken no account of how people's financial circumstances change over time. But people who are relatively poor today may enjoy higher incomes tomorrow, in which case they might not need the welfare state even though they show up in our statistics as among the lowest income recipients at a particular point in time. If their incomes fluctuate, then it may be possible for them to save or borrow so that some of the money earned in the good times is available to support themselves when things get harder. Smoothing out their incomes in this way, they would not then need the welfare state to bale them out on the occasions when money is tight.

Evidence indicates that individuals' financial circumstances can change quite dramatically, even over relatively short time periods. As they move from training into employment, between work and unemployment, from being married to being divorced, or from parenting to empty-nesting, people's incomes can vary dramatically. Undergoing transitions like these, the same person can find him- or herself at one end of the income distribution this year, and at the other end the next.

Tracking a sample of workers earning less than $10 per hour in September 1994, for example, Yvonne Dunlop found that only a quarter remained low-paid over the next three years. She concluded: 'For a significant number, low-paid employment appears to be temporary with many able to move to higher paid work quickly'. She also found that, having made it to a better job, these workers had a 'high chance of staying out of low pay', particularly if they were young.[40]

The same pattern recurs when we look at people who are living on welfare benefits, for many of them are in transition to self-reliance. Half the people who go onto unemployment benefits, for example, find another job within eight weeks.[41] Single parents and retired people tend to spend long periods on welfare, but most other claimants are short-term.[42]

We also know that poverty is frequently transitional. Defining 'poverty' as a household disposable income below 50% of the median income, the HILDA

household panel survey found 13% of Australians were 'poor' in 2001, but less than a quarter of these people (3% of the total sample) were still 'poor' when they were re-interviewed in 2002 and 2003. Long-term poverty is the exception, not the norm. As the HILDA report puts it: 'Most people who become poor soon cease to be poor.'[43]

Furthermore, when people move out of poverty, they often become relatively comfortable fairly quickly. Looking at people in the HILDA survey who fell into poverty in 2002, for example, two-thirds had escaped it by the following year, and most of them had secured an income at least one-third the way up the income scale. One in six of them made it to the top half of the income distribution within twelve months.

Evidence like this suggests that substantial numbers of people who are net tax-welfare recipients at one time might become net payers at another. Even those of us who are not paying the full cost of our own benefits at the time we receive them commonly end up paying for them later.

This being the case, much of the income redistribution which appears to be taking place within the welfare state from more to less affluent people at any one time might better be understood as a redistribution between the higher-earning and lower-earning stages of people's own lifetimes. In other words, it is not so much that Peter's taxes are paying for Paul's welfare benefits, but that Peter's taxes are paying for his own later welfare withdrawals, and that Paul's benefits are drawing down on his own earlier tax contributions.

This is clear in the case of many older, retired people. They tend to be over-represented in the lower income deciles, which means they often receive more in state benefits than they pay in tax. Younger, working people, on the other hand, are more likely to be found in the higher income deciles where tax paid exceeds the value of government benefits consumed. Viewed statically (as in Tables 2.3 and 2.4), we would conclude that the tax-welfare system is redistributing money from richer people to poorer ones, but viewed in a lifetime perspective, people who paid into the system when they were working are simply getting their own money back when they retire. Much of what appears to be inter-personal redistribution is thus revealed as intra-personal income-smoothing over the life-course.

Lifetime churning—the welfare state as a national piggy bank

Because we pay more money into the tax-welfare system at more prosperous periods of our lives, only to draw the money out again in poorer periods, the welfare state is effectively forcing us to borrow from and lend money to ourselves. The NATSEM research summarised in Table 2.5 hints at precisely this, for the Table shows that, when private incomes are high (early in life, before we have children), receipts from tax/welfare churning tend to be negative, and when private incomes fall (particularly after retirement), receipts from tax/welfare churning tend to be positive. Given that many households in the middle years tend to come out roughly neutral, we can see from this Table that much of what the welfare state is doing is transferring money across the lifecycle from when we are young and prosperous to when we are old and poorer.

Such 'income smoothing' over the course of a lifetime is necessary and important, but why does the government have to do it for us? Why couldn't we be left to save, invest and insure for ourselves? If most working people can afford to pay the taxes necessary to fund their lifetime needs, why could they not equally well afford to pay this money into their own, private savings and investment accounts instead? Why does income smoothing has to take the form of government tax-welfare lifetime churning?

To gauge how many of us really need to rely on the welfare state to keep our heads above water, we have to look at total lifetime incomes, not just at people's household budgets at one point in time. We need to know how many people earn too little *over a whole lifetime* to look after themselves unaided by the government. The answer is: surprisingly few.

Ann Harding estimates that only one-quarter of the individuals in the bottom decile of incomes in any one year end up in the bottom decile of total incomes accrued over a whole lifetime, and that one in twenty of them ends up in the top lifetime decile.[44] This suggests that many of the people who depend on welfare state benefits at one time or another during their lives could have resourced these transfers themselves out of earnings accruing at more prosperous periods. Indeed, Harding finds that even those who earn the lowest total incomes over a lifetime still end up paying for a substantial proportion of all the welfare benefits and services they consume.

Looking only at income support payments (which are used mainly by people on low incomes), and at direct taxes (which are paid mainly by people on high incomes), she estimates that people in the bottom 10 percent of lifetime earnings still pay 12% of their lifetime incomes in tax used to fund government cash transfers while receiving 21% of their lifetime incomes as welfare payments.[45] In other words, *those who earn least in the course of their lives still pay in income tax for more than half of all the income support payments they receive*. Indeed, Harding finds that males in the bottom lifetime income decile end up paying for *all* of the benefits they receive, for most of the redistribution that occurs over a lifetime takes place between men (who are employed for most of their lives) and women (who often spend long periods out of the labour force and who tend to live longer in retirement).[46]

When Harding adds indirect taxes to her analysis, the total tax payments made by lower income groups in the course of their lifetimes works out even higher (for the burden of indirect taxation is more evenly spread down the income distribution), and the degree of lifetime churning therefore increases accordingly.[47] And when her analysis is expanded yet again to include the value of government services (such as health and education) as well as income support payments, the total amount of lifetime churning at the bottom end rises further still.

Basing her calculations on the 1986 tax and welfare system (but updating her figures to 2006 prices),[48] Harding finds that the poorest 10% of Australians receive $177,000 worth of health care over a whole lifetime, but that they contribute $62,000 of this in the direct and indirect taxes they pay (the richest 10% of Australians, by contrast, pay $249,000 into the state health system to get $76,000 worth of services back, although they supplement these socialised health benefits with private health care). Although there is clearly some inter-personal redistribution going on here, *each individual on*

average funds 73% of his/her lifetime consumption of government health services through the taxes he or she pays.[49]

Education spending too involves substantial lifetime churning, with the biggest lifetime earners taking out $12,000 more (in 2006 prices) in education services than those at the bottom do. This disparity arises mainly because higher lifetime earners consume more education earlier in their lives (state funding of higher education is notoriously regressive in its distributional effects). This regressiveness would be even greater were it not for many wealthier individuals opting to receive much of their education outside the state sector.[50]

Reviewing all this evidence, Ann Harding concludes: 'Over the lifetime there is significant 'churning' as taxes paid to government at some point in the lifecycle are returned to the same individuals at some other point'.[51] She does not calculate the overall proportion of total welfare state spending that goes in inter-personal transfers as against the proportion that goes on lifetime churning, but it is clear that churning represents at least half of it (much more in the case of services like health, where about three-quarters appears to be self-funded).

It is important to note that Harding's calculations of lifetime churning are based on the 1986 tax and welfare system (she estimates the lifetime tax paid and benefits received by a cohort born in 1986, assuming the tax and welfare systems remained unchanged through their lifetimes). Much has changed in the last 20 years, so the precise estimates of tax and benefit shares for different lifetime income deciles would be different if the same calculations were repeated today. But what has not changed is that the welfare state continues to operate as much as a system of compulsory lifetime borrowing and saving (the 'piggy bank' function) as it does as a system for redistributing incomes between different individuals (the 'Robin Hood' function). Many of us will still end up paying for most or all of our own benefits—if not at the time we use them, then at other points in our lives when we are more prosperous.

The obvious question is why not leave us to use our own money to make provision for ourselves, rather than taking all this money away in tax only to give it back, now or later, as government cash benefits or services? If so many of us are already paying for what we receive, why do we need the welfare state to process the transactions for us?

Tax-welfare churning in comparative perspective

Some analysts have argued that tax-welfare churning is not as extensive as I have suggested.[52] They insist that, in comparison with other developed countries, churning in Australia is relatively modest. They conclude from this that churning is not a serious problem in this country, and that it could not easily be reduced given that it is already lower than in most welfare states.

It is certainly true that churning is even more extensive in most European countries than it is in Australia. In the UK, for example, between two-thirds and three-quarters of total welfare state expenditure is devoted to intra-personal 'income smoothing' (that is, taking money away from people during affluent periods of their lives in order to return it to the same people in poorer periods), with as little as a quarter going on transfers between different recipients. According to the definitive British study of

churning: '*Most* benefits are self-financed over people's lifetimes, rather than being paid for by others. Of the £133,000 average gross lifetime benefits from the system, an average of £98,000 is self-financed. Nearly three-quarters of what the welfare state does looked at in this way is like a "savings bank"; only a quarter is "Robin Hood" redistribution between different people'.[53]

Similar patterns have been reported for other European countries. Rojas finds much the same sort of churning going in Sweden, and Foelster, reviewing several western countries, concludes that between 75 and 80 per cent of their social expenditure consists of redistributing individuals' incomes over time rather than between different people.[54]

The reason why churning in Australia is less extensive than in these other nations lies in the distinctive way our income support payments system is funded. Unlike almost all other advanced welfare states (New Zealand is the other exception), Australia never developed a contributory system of state social insurance.[55] This means that, unlike other nations, we do not deliberately give welfare payments to lots of prosperous people who do not need the money.

In the UK, for example, every worker pays National Insurance (NI) contributions which entitle them to receive a government age pension when they retire, as well as a range of other social security benefits. This means that even the richest retirees in Britain get a full state pension provided they have paid their full NI contributions during their working lives. This obviously results in a higher level of lifetime churning than in Australia, where age pensions are non-contributory and means-tested. The richest Australian retirees do not qualify for a government pension, even if they have handed over huge sums in taxes during their working lives, and this reduces the extent of lifetime churning considerably.[56]

This explains why our total welfare state expenditure is below the OECD average. It is because Australia subjects age pensions and other cash benefits to an income test.[57] But while we do not spend as much on our welfare state as most European countries do, much more of what we spend goes to people on lower incomes precisely because we rely more on means testing. Peter Whiteford finds that Australia runs the most targeted welfare system in the developed world. He calculates that the net amount of government cash transfers going to the poorest 20% of Australians (after income taxes and welfare benefits are taken into account) is higher than in any of the OECD countries for which this calculation can be made. In relative terms, the Australian welfare state redistributes more money to the poor even than Denmark's.

The high level of targeting in the Australian system means that tax-welfare churning is lower here, for prosperous households do not normally qualify for government payments. It is therefore no surprise when Whiteford finds that Australia has the lowest level of simultaneous churning of any OECD country, for the top income earners pay high taxes but receive relatively few welfare payments.[58]

It is important, however, to add two immediate qualifiers to this conclusion. The first is that Whiteford's comments apply only to cash transfers (the income support system). When we extend the analysis to include government spending on health and education services, Australia is little different from any other advanced country, for

every household is entitled to use government schools and health care services (although in practice large numbers pay twice by buying into the private sector instead). Furthermore, while the rich are excluded from a number of welfare benefits in this country, they still qualify for some (for example, the millionaires' wives claiming FTB Part B), and targeting has grown weaker in recent years.

The second important qualifier is that means testing in the Australian income support system does little to exclude the comfortable middle class from receipt of cash benefits. Simultaneous tax-welfare churning may be low by international standards when we look at the richest 20 percent of Australian households, but below that income level it is just as prevalent as anywhere else in the developed world. As Whiteford himself admits: 'In virtually all OECD countries, the middle 60% of households receive between 50 and 65% of all transfers, with Australia being towards the lower end of this at 56%... In this specific sense, *Australia has roughly the same share of "middle class welfare" as most other OECD countries*… What is unusual about Australia is the smallness of the share going to the richest 20% of the population, this being only 3% of all transfer spending.'[59]

When it comes to the 'middle mass' of the population, therefore, tax-welfare churning is just as prevalent here as it is in Europe. Whiteford calculates that, when we include indirect taxation as well as income taxes, and the value of government services as well as cash benefits, an average of 18% of all the income earned by Australian households is handed over to the government in taxes and then simultaneously churned back to the same people as welfare state payments or services.[60]

Implications

Imagine for a moment that our current welfare state were scrapped in its entirety. Total government expenditure at federal and state levels would plummet from around $260 billion per year to about $80 billion. This would result in huge tax cuts. With savings of this magnitude, government could scrap all tax on personal incomes (including taxes on superannuation, the Medicare levy and payroll taxes) *and* get rid of the GST. Every worker would then keep every cent they earned, and the price they paid for the goods and services they buy would fall by 10 percent.

In that situation, many Australians would be able to purchase the same or better quality services as they currently get from the welfare state without experiencing a significant fall in their net incomes or living standards. Rather than receiving fortnightly government family payments, for example, people with children could look after their own offspring without any outside assistance. Similarly, rather than relying on the government to transfer chunks of their income from the richer to the poorer periods of their lives, most people could organise this for themselves by insuring against ill health and saving for their old age, using their tax savings to pay for the insurance premiums or the superannuation contributions.

The problem with this scenario, however, is some people would not have enough money to enable them to save, insure and buy the services they need. Not all welfare state expenditure is churned; some of it is redistributed to people who would not otherwise be able to afford all the services they need, even if they spread the cost over their entire lives through saving, borrowing and insurance. As the NATSEM research

team reminds us, 'It is important in this debate not to lose sight of the redistribution by the welfare state from richer to poorer Australians, as well as from younger to older Australians.'[61]

So the government's role in ensuring people's welfare needs are met cannot be abolished in its entirety. Some provision still has to be made for people whose lifetime incomes are insufficient to enable them to provide for themselves and who would suffer if current arrangements were wound up and nothing was put in their place. Most obviously, people who cannot earn an income in the course of their lives due to some permanent mental or physical incapacity still require support from the wider community. Households whose lifetime earning capacity is limited in some other way (perhaps through low skills or interrupted career earnings) may also need the state to 'top-up' their spending power before they can join everybody else in self-providing.

The crucial question, therefore ,is how many people need this sort of help? How big does the welfare state need to be if the poorest and weakest are still to be protected?

We have seen that at least half of all welfare state spending is self-financed in the course of a lifetime (that is, at least half of all welfare expenditure is churned). Although it is probably an under-estimate, let us therefore cautiously assume a 50:50 split in the current budget between intra-personal churning and inter-personal transfers.

With this in mind, imagine a second scenario where the 50% of total welfare state expenditure that currently goes on churning is stripped out of the welfare budget and left in taxpayers' pockets. Total welfare state spending would be reduced from $182 billion to around $90 billion, releasing the other $90 billion or so for tax cuts. This would still be almost enough to abolish all personal income tax. Or government could scrap the GST (at a saving of $35 billion), give every taxpayer a $20,000 annual tax-free earnings allowance, introduce a flat tax of 25 cents in the dollar on earnings above this threshold, and still have enough left over to scrap the Medicare Levy, Fringe Benefits Tax and the 15% tax on superannuation contributions.[62]

Even this more modest scenario is, however, unrealistic, for it would be very difficult, if not impossible, to eliminate all tax-welfare churning. A substantial amount of churning, for example, involves revenues collected through indirect taxes like GST or stamp duties, and it is difficult to think of ways this might be reduced (although Appendix II considers how it might be done). There are also major problems with reducing churning on the expenditure side, particularly when it comes to the cost of schooling. Workers on a wage of $50,000, for example, faced a 2005-06 income tax burden of $11,172. If nearly all this burden were lifted from their shoulders, they could probably afford to save for their retirement, insure or save for their health needs, and insure against risks like unemployment and sickness. But if they had children they would still need help meeting the cost of school fees, and it is difficult to think of viable schemes which might allow their children to spread the cost of their own education over their later lifetime of earnings.

So let's accept that the full $90 billion or so of tax-welfare churning cannot be eliminated. But it can be cut back. There is still a lot of scope to reduce churning and

thus to reduce taxes, leaving people with more of their own money to provide for themselves. Radicals may be disappointed that more cannot be done, but every bite we manage to take out of the $90 billion of government spending that is currently being churned is worth taking, for $90 billion is an awful lot of money. The more we cut into this churned expenditure, the more households can reduce their demands on government and begin to fend for themselves.

Meanwhile, the remaining $90 billion of tax revenue that is currently being redistributed rather than churned can still be spent supporting those who need help. The fact that so much welfare state expenditure is currently churned means we can restore self-reliance to many people across key areas of their lives while still ensuring that households that need support continue to get the help they require. Cutting back the welfare state in a context where half of all spending is being churned means we can build self-reliance without hurting the vulnerable. In Chapter 5 we shall see how this could be done.

Conclusion

The welfare services we consume do not come 'free', despite the misleading rhetoric of welfare professionals and politicians who talk of services 'free at the point of demand'. Either we pay through compulsory taxation for the education, health, age pensions and income security insurance that we consume, or we pay for these things through our voluntary purchases. Either way, we end up paying—the question we have to ask is whether the money we are currently handing over in taxes could be better spent by organising our affairs for ourselves.

We have seen in this chapter that it is theoretically possible to shift from compulsion to voluntarism, from state taxation to personal choice, without driving people into destitution. Winding down the 'piggy bank' function of the welfare state would still leave $90 billion per year to spend on people who need help. There is no reason why they should be any worse off after a reform like this than they were before it.

But just because people would be no worse off is not itself a good reason to embark on radical reform. The key question we now have to address is why this change is worth making.

CHAPTER THREE: WHY CHURNING IS BAD FOR YOU

'Many people [have been left with] with very little of importance to decide for themselves, even in their own private spheres. They are educated by the state (at least nominally), as are their children in turn; the state provides for them in old age and has made saving unnecessary or, in some cases, actually uneconomic; they are treated and cured by the state when they are ill; they are housed by the state, if they cannot otherwise afford decent housing. Their choices concern only sex and shopping… For those at the bottom, such money as they receive is, in effect, pocket money, like the money children get from their parents, reserved for the satisfaction of whims. As a result, they are infantilised'.

Theodore Dalrymple 'The roads to serfdom' (2005)[63]

Some economists can't see why churning matters. Peter Whiteford asks why we should be concerned if money taken in tax is later returned to the same people in the form of benefits or government services. Provided the tax office and the welfare agencies are efficient in producing the outcomes we are after, why should it matter which office does what?[64]

Another economist, Nick Gruen, agrees with him. We want our tax and welfare systems to take money from those who can afford it, and to allocate it to those who need it. By and large, this is what the Australian system does, more effectively and efficiently than almost any other comparable country. Gruen even boasts that Australia has 'the world's best social security system,' and describes our record in minimising churning as 'stellar.'[65] If that's the case, how can we be said to have a problem?

Gruen suggests that if the idea of churning bothers us, we can simply define it away. The problem of churning in the family support system, for example, could be solved by redefining family payments as 'tax credits.' The same amount of money would still be taken from people in tax, and returned to them in family payments, but 'tax-welfare churning' would have been eradicated because the whole cycle would now be managed by the Australian Tax Office without involving Centrelink and its 'welfare' payments. In reality, says Gruen, nothing would have changed except 'the optics.'[66]

Critics like Gruen and Whiteford believe a focus on churning is misplaced because what matters is the net distributional outcome of money flows, not the way we get these outcomes. Provided the money-handling agencies operate reasonably efficiently, it doesn't matter whether the tax office does this, or Centrelink does that. All that matters is that the right people end up getting the financial help they need. Seen in this way, churning is a non-problem.

But this kind of thinking is short-sighted for a number of reasons. For a start, Gruen is wrong to think that churning is limited to the family payments system. As I show in Appendix I, single parents and unemployed workers also often end up claiming benefits and paying tax at the same time.[67] This is not only bureaucratically inefficient

and costly; it also destroys work incentives. A lot of churning is subverting the outcomes the policy-makers are trying to encourage—things like increased workforce participation and reward for effort. The churning problem is bigger and much more serious than Gruen admits.

Nor are inefficiency and perverse outcomes the only concern. Indeed, they are not even the main concern. The core reason why churning matters is that a dollar earned has a very different meaning and significance for people than a dollar received from the government. By taking tax from people of modest means, government is forcing them to rely on hand-outs and public services rather than buying what they want using their own resources. Churning is in this way destroying people's independence. That is why it matters. In Theodore Dalrymple's phrase, it is infantilising us.

It is no coincidence that those who think churning is not a problem tend to be economists, for they fail to grasp the importance of what is essentially a sociological issue. They are focused solely on net money flows and are blind to what it *means* to the people involved to have to rely on the government's money rather than being free to spend their own. Peter Whiteford, for example, attacks the concern with churning for 'concentrating on appearances rather than reality,'[68] but he fails to understand that what he calls the 'appearances' *are* the reality. He and Nick Gruen think getting money back from the government is no different from never having it taken away in the first place, but they fail to appreciate the world of difference between keeping what you earn, and getting your tax money back as a government benefit. What these two critics dismiss as nothing more than 'optics' and superficial 'appearances' are actually the nub of the problem.

This chapter identifies six key reasons why churning is bad for you and why allowing people to spend their own money on the services they want is preferable to taxing them to provide them with the services the government thinks they should have.[69] Some of these are economic reasons, to do with allocative efficiency and financial incentives. But we shall see that the most important reasons are sociological, political and even psychological, and have little to do with economics. When it comes to churning, the efficiencies and the net distributional outcomes are important, but what matter more are precisely the 'optics' and the 'appearances.'

Reason (1) Inefficiency

Peter Whiteford does not believe that reducing or eliminating churning would raise efficiency.[70] Taking the example of family payments, he suggests that leaving money in people's pockets (for example, by raising their tax-free earnings allowances) makes them no worse and no better off than taking it away in tax and returning it to them later as FTB. The net effect is the same.

But the net effect is not the same, for this argument ignores the bureaucratic cost of churning. When the government taxes people's earnings, and then returns their money to them in the form of welfare benefits or services in kind, it always takes a slice off the top to cover its *administrative costs*. It has to pay for two giant bureaucracies (a tax bureaucracy to take people's money away and a welfare bureaucracy to give it back again).

Nor is this the only inefficiency incurred as a result of churning. Government also imposes *compliance costs* on private citizens and businesses, which have to devote time and money meeting the rules governing the tax and welfare payments, and it generates *enforcement costs* as it tries to detect and chase people who evade payment of tax or who fraudulently claim benefits. Cutting down on churning would reduce all these costs and, other things being equal, would therefore leave people better off than they are under the current complex system.

Lower administrative and compliance costs

Federal tax legislation currently runs to more than 9,000 pages. In excess of 20,000 people are employed at the Australian Tax Office (ATO) to supervise the increasingly complex procedures by which money is taken away from citizens and transferred to the government. In 2002-03, taxpayers paid over $2.3 billion just to cover the costs incurred by the government in taking their money away from them.[71] Our tax system is now so complex that even the ATO itself struggles to understand it, and tax officials increasingly end up making up the law as they go along.[72]

To the administrative costs incurred as a result of this complexity and intrusiveness must be added the compliance costs incurred by private citizens and businesses at the receiving end. Three-quarters of Australians feel the need to employ accountants or financial advisors just to help them make their annual tax returns. Membership of the Institute of Chartered Accountants stands at a staggering 40,000 members. Alex Robson calculates that the 'tax army' of government officials, accountants and lawyers who make a living from the tax system is three times larger than Australia's military army.[73]

The welfare system is even more complex and costly. Centrelink alone employs nearly 25,000 people, and to them we have to add thousands more employed in federal and state welfare departments, as well as those employed in commercial and not-for-profit agencies which contract with the federal government to run the Job Network's employment services.[74] Then there are all the employees in the state and federal bureaucracies administering the health and education systems—the clerical officers who calculate and process thousands of Medicare co-payments every day, the bureaucrats who administer the different state government hospitals, and the officials who sit in the various state capitals deciding how each government school should spend its budget and enrol its staff.[75] All this micro-management involves a plethora of government departments and agencies, often operating across different levels of government, and tens of thousands of public servants are needed to administer it.[76]

Of course, any move from state to private transactions would also incur administrative overheads, for private savings schemes, insurance policies and loans packages still have to be managed by the financial institutions that offer them. But self-funding does not employ bureaucracies to take money from people and then hand it straight back again, and competition could be expected to drive down costs and charges which generally expand in public sector monopoly conditions. A move towards self-funding of services would cut out many 'middle men and women' as consumers contract directly with the providers of the services they want to buy.

Lower enforcement costs (less snooping)

Self-funding would also reduce the detailed scrutiny of each individual's personal circumstances which is needed under a system of state provision to determine eligibility for benefits. This would reduce costs and strengthen civil liberties.

When government distributes benefits, there is an inherent problem of determining eligibility, and some degree of fraud and/or over-claiming is inevitable. In 2004/05 the Commonwealth Director of Public Prosecutions successfully prosecuted 3,446 people for fraudulently claiming benefits from Centrelink,[77] but this was almost certainly the tip of the iceberg. As one senior fraud investigator observed, 'The DPP has an aversion to taking on anything risky in case they damage their statistics.'[78] Over half a million payments totalling more than $2 billion per annum were cancelled or reduced that year as a result of Centrelink entitlement reviews.

Further evidence that a lot of claimants are earning money 'on the side' which they are not declaring to Centrelink comes from research showing that people on unemployment benefits who are required to undertake some mutual obligation activity declare 'other earnings' at a 30% to 40% higher rate than other unemployed claimants. This is because fulfilment of a mutual obligation requirement makes it much more difficult to hide existing, informal economic activity.[79] The National Audit Office estimates that about $1 billion is lost each year in fraudulent claims and overpayments, more than one quarter of it on the Newstart unemployment allowance. This is the equivalent of $535 per unemployed claimant per year.[80]

All this fraud takes a lot of policing. One of the most attractive features of a move to self-funded welfare is that, as well as being less intrusive than state provision, it requires little policing. In chapter 5, for example, we outline a proposal that, instead of relying on state unemployment benefits, people should build up their own unemployment savings to provide them with an income in periods when they are between jobs. If this idea were implemented, no government department would be needed to process claims and distribute money, for people would be drawing on their own funds. Nor would government agencies need to check whether claimants were defrauding the system, for people would not be claiming public money. There would arguably be little need even to monitor claimants' job search activities, for it would be in their own interests to get another job before their funds ran dry. 'Bludging' under a system like this would be counter-productive, for those seeking deliberately to avoid work would only be defrauding themselves.

Unlike state welfare, self-funding works because it runs with the grain of human self-interest, rather than fighting against it. This makes it much cheaper to organise.

Reason (2): Disincentives

The high taxes which inevitably flow from the operation of a mass welfare state generate severe work disincentives. The cost of these can be measured by calculating what economists call 'deadweight losses'—the value of all the work and output that is lost to the economy as a result of an increase in the tax on people's incomes.

How cutting churning reduces deadweight losses

When income taxes rise, some people decide to work fewer hours while others conclude it is not worthwhile training for an additional qualification, or that it makes sense to stay on welfare rather than look for a job, or that it is not worth taking the risk of setting up a company of their own. All these decisions represent potential wealth lost to the economy because high taxes have dissuaded people from making the additional effort, or taking the additional risk, involved in pursuing new activities. Equally, of course, if taxes were to fall, these deadweight losses would be transformed into gains as productive activity increased.

Alex Robson estimates that the total deadweight losses arising from personal taxation in Australia could be as high as $61 billion per year—a staggeringly large sum. He estimates that each additional dollar of personal taxation ends up costing at least $1.20 in lost output once deadweight losses are factored into the calculation. These deadweight losses weigh heavily on our prosperity. Countries which have significantly cut taxes over the last 20 years have enjoyed average per capita growth rates nearly *three times* higher than those that have not.[81] Tax cuts consequent upon a significant reduction in welfare churning could therefore be expected to feed through in a substantial rise in personal living standards.

Net effects versus marginal effects

The federal government likes to claim that taking tax from people and then returning it in the form of government payments is little different from giving people a big tax cut, because they end up with the same amount of cash in their hand at the end of the day.[82] But this argument ignores the problem of deadweight losses and the disincentive effects that go with them. Cutting taxes encourages people to work harder and create more prosperity, but recycling their money does not. Indeed, far from strengthening work incentives, a policy of high tax deductions coupled with high welfare payments weakens incentives because of the high ‘effective marginal tax rates’ that result. To reap the incentive effects of tax reductions, it is necessary to reduce tax. Compensating people with selective welfare top-ups does not do the trick.[83]

Means-testing in the Australian welfare system is a major factor militating against risk and hard work, for as soon as people work harder and earn more, not only do they pay more tax, but they also start to lose their government benefits. This double-whammy creates very high rates of ‘effective taxation’ at the margin (that is, people retain relatively little of each new dollar they earn), and this depresses incentives. For this reason, Peter Whiteford doubts whether reducing churning would strengthen work incentives, for he assumes churning can only be reduced by tightening means-testing of benefits even further, thereby making the work disincentives even worse than they are already.[84]

But reducing churning does not necessarily have to involve tighter means testing of benefits. It could involve taking people out of the benefits system altogether and taxing them less. If people needed to rely less (or not at all) on government payments while paying less (or no) tax on their incomes, their work incentives would be much stronger than they are now. This is the right way to reduce churning, and we shall see in Chapter 5 how this might be achieved.

Reducing churning in this way would not necessarily increase people's net incomes, because much of the money they save on taxes would have to be devoted to increased expenditure on things like health insurance and savings for old age. It is therefore quite possible that people would be no better off than before once all their basic needs had been paid for. But the incentive to work harder and save more would be strengthened because they would be retaining and spending more of their own money.

Consider Singapore. As we shall see in Chapter 4, Singaporeans are required to self-fund many of the services which in Australia are provided by state and federal governments out of tax revenues. Because there is only a very limited welfare state,[85] taxes are low, but workers have to pay 20% of their earnings (up to an income ceiling) into personal funds, with their employers having to supplement this with a further 20%. Workers draw on these funds to pay hospital bills, tertiary education fees, life and disability insurance and to finance retirement savings.[86]

Because low taxes in Singapore are counter-balanced by high compulsory savings levies on wages, it could be argued that workers have little more disposable income than they would have had under a mass welfare state system. But the difference is that deductions from their wages go into their own personal funds rather than disappearing into the government treasury. This means workers defer income but do not lose it. The money is invested to secure asset growth, rather than being spent financing current government liabilities, so workers accumulate wealth.[87]

The lesson for Australia is that, if the tax burden imposed by the increasingly costly welfare state could be lifted so that workers retained more of what they earned (either as disposable income or as long-term savings), economic incentives would certainly strengthen. In this way, scaling back the welfare state could make us all richer.

Reason (3): Long-term unsustainability

Like most other advanced capitalist countries, Australia is facing the inevitability of an ageing population. This is the result of increasing life expectancy and falling fertility rates. Across the western world, this is posing two huge problems for welfare states which developed during the 20th century: a shortfall in funding for state retirement pensions and a looming crisis in the cost of government health care for the elderly. A switch to self-funding is increasingly being touted as the only viable, long-term solution to both of these problems.

The crisis of 'pay-as-you-go' state pensions

Because almost all western countries fund their state age pensions out of current tax revenues rather than from accumulated funds, an increase in the proportion of the population over retirement age poses questions about how future generations of retirees will be funded. A dwindling workforce supporting a burgeoning number of retirees means that existing pay-as-you-go (PAYG) systems can only survive under one of two scenarios. Either the value of government age pensions must fall (through a cut in the weekly value of payments, or a postponement of the statutory retirement age), or the proportion of wages taken in taxes must rise. Neither option is likely to prove palatable to voters.

There is, however, a third option, more attractive in principle than either of the other two. This involves shifting from pay-as-you-go state pensions to fully-funded personal pensions. Rather than one generation of workers paying the pensions of an older generation of retirees, each generation of workers would then accumulate money for their own retirement in their own funds.

The key problem with this third option is how we get from here to there. Whenever the changeover happens, an existing cohort of workers will get caught in a double-payment trap, for they will still have to fund the pensions of their parents' generation at the same time as they put money away in their personal funds to cover their own future retirement.

Some commentators think they can find ways around this problem,[88] but in the end it is probably insoluble. One way or another, some people will have to pay twice in any transition. The reason is that the very first generation of state pensioners got something for nothing, and their debt has been passed on across successive generations ever since. For as long as the working population kept growing in relation to the retired population, this did not matter, but today, with the prospect of an ageing population, Generation X has suddenly been left holding the parcel as the music stops.

In Australia, this problem is less urgent than in most other western countries. This is partly because our population is younger (only 33% of post-school Australians will be aged over 65 in 2030, compared with 37% of Americans, 39% of Britons and 49% of Germans),[89] but it is also because we have already embarked on a self-funded alternative to the state pension—the Superannuation Guarantee (SG).

The SG has been running since 1992. Ever since then, workers have been paying twice (once in their taxes to cover the payment of age pensions to current retirees, and again in the compulsory superannuation contributions paid from the wage fund by their employers to cover their own retirement). Because the SG contribution is relatively low (9% of salary), and because the period since 1992 has been one of strong and sustained real earnings growth, this has not felt too painful.

The existence of our SG scheme will not completely avoid the looming crisis of our state age pension scheme, however, for the 9% employer contribution is probably too small to provide most workers with an adequate retirement income. If nothing else is done, demand for a top-up from the means-tested state pension will therefore remain high.[90] Even when the state age pension is added to their personal super, the total retirement income of many baby boomers is expected to fall short of the recommended level of 60-70% of pre-retirement income, although the generation following them (which will have paid into personal superannuation for much longer) is expected to fare better.[91] Many retirees will therefore continue to access the state pension as well as their own super funds unless something is done to boost the level of contributions (currently, fewer than one in five retirees is wholly self-reliant).[92]

Australian government spending on age pensions is projected to rise by 1.7 percentage points of GDP over the next 40 years. While still exerting upward pressure on taxation, this is substantially below the projected OECD average, and it is deemed 'manageable' by the Treasury.[93] Because Australian workers have been 'paying twice' since 1992, we are 15 years ahead of the US and much of Europe, and if self-

reliance can be strengthened in the years ahead (for example, by eliminating taxes on contributions for people who agree to opt out of their pension entitlement), the cost burden of the state age pension for future generations could in time even be reduced.

The crisis of health funding

There is, however, a second and even more pressing reason why an ageing population threatens to destroy western welfare states, and this has to do with pressures on health care funding. Here Australia is less well prepared than on pensions.[94]

The federal government's *Intergenerational Report* predicted a doubling of federal health spending (from 4% to more than 8% of GDP) in the next 40 years. Three-quarters of this increase will come from advances in health technology (for new treatments are expensive and they increase demand), while the remaining quarter will be generated by the ageing of the population (more elderly people means more demand for high-cost health care).

The biggest increase will come in the cost of the Pharmaceutical Benefits Scheme, up from 0.6% to a breathtaking 3.4% of GDP in forty years.[95] But there will also be a big increase in demand for nursing home and community-based care for elderly people as the population ages. Age care currently costs the federal government 0.7% of GDP, but the number of people needing care is expected to triple by the middle of this century, and costs are expected to rise to 1.7% of GDP.[96]

The biggest factor driving this huge predicted rise in government spending on health and age care is public demand for newer and better health treatments. For as long as governments take responsibility for providing health care, the public will continue to demand the best that money can buy, but no government can be expected to supply unlimited health care to everyone.

The obvious way to contain these pressures is to transfer more responsibility for meeting the costs to consumers. Under current arrangements, people can demand more and better drugs or treatment with little regard for the cost implications. A shift towards greater self-funding would allow those who really do want to devote a rising percentage of their incomes to health care to do so without imposing an additional financial burden on other taxpayers who may have other priorities.

For example: Much of the upward pressure on health care costs is accounted for by the huge cost of so-called 'End of Life' treatments administered in the last few weeks or months of life to patients with advanced or terminal diseases.[97] The US currently spends 27% of its total Medicare budget on End of Life treatments, but as Charles Murray points out, delaying death by a few more weeks is probably the least cost-effective way of spending healthcare dollars. If everyone was required to take out private health insurance, those who wanted to receive every conceivable treatment to stave off dying could pay for this in higher premiums while other people could opt for lower rates and settle for simpler palliative care in their last days on Earth.

Unless significant numbers of people start to take more responsibility for their own retirement and health care needs, we are going to end up in 30 or 40 years time with a dwindling base of younger taxpayers having to fund an increasingly burdensome

population of claimants making increasingly unrealistic demands on government spending. The way to avoid this nightmare scenario is to enable people who wish to do so to build up their own health savings, and to take out their own private health insurance, rather than relying on the government system. We shall consider how this might be done in chapters 4 and 5.

Is pre-funding a real solution?

By encouraging or requiring people to commit part of their current income to meeting their future needs, the financial burden of caring for them in their old age is transferred from the shoulders of the generation behind them onto those who will actually receive the benefit. Self-funding means you reap what you have sown rather than imposing a debt on those who follow you.

But is it really this simple? Some analysts argue that, no matter how the finances are organized, the next generation will always have to pick up the tab for the care of its elders because future spending will always depend on future output. Whether pensions are financed by current tax revenues or by personal savings, the flow of income available to retirees will still depend on the total value of goods and services being generated at the time when their entitlements have to be paid out. As Nicholas Barr puts it, 'Whichever method is used, *what matters is the level of output after I have retired.* The point is fundamental… money is irrelevant unless the production is there for pensioners to buy.'[98]

If the population is ageing, there will be fewer productive workers in the future to support more retirees. This obviously affects state PAYG pension systems (for taxes will have to rise to pay the same level of benefit), but it also impacts on pre-funded personal ones. This is because, when individuals retire, they want to convert the bonds, shares or other assets in their personal super accounts into an income stream. If the population is ageing, there will be fewer workers around to buy these assets, so their value will fall and annuities will be worth less. State pensions and private superannuation funds are therefore both at the mercy of an ageing population, and the only real solution for both is to increase productivity.[99]

There are nevertheless two important differences between state and personal funding of pensions which mean individuals are likely to fare better if they switch from the former to the latter.

One is that in a state pension system, the value of your future payments depends entirely on what a future generation of voters and politicians decides to give you. With your own personal plan, by contrast, you can increase or decrease the size of your claim on future output by changing the size of your contributions, as well as switching the balance of your asset holdings to take advantage of market changes. A personal savings model gives you the power to determine the size of your claim on future output.

The second advantage of personal funding is that the resources it buys are not tied to one country's population base. Barr acknowledges this point—while a PAYG state pension can only draw on the output generated by the taxpayers of that state at the time the pension is paid out, a private pension fund can invest across the globe,

seeking out higher returns from countries with younger, growing and more productive workforces. By purchasing assets in India or China, for example, private pension managers can effectively escape the limits of an ageing population in their own country and can thereby ensure a much higher stream of retirement income for their members than would be possible under a national government's tax-funded pension (while also providing developing countries with much-needed investment capital).

Reason (4): Personal disempowerment

The economic justifications for moving from state provision to self-funding are strong, but the sociological and psychological arguments are even stronger. Arguably the most important reason of all has to do with the satisfaction to be derived from having control and responsibility for one's own life.

When people earn their own money and use it to provide for themselves and their dependents, they experience a sense of autonomy, self-worth and personal responsibility which is denied them if their money is taken from them in taxes and then returned as government benefits and services. The early friendly societies understood this, which is why they so passionately defended their autonomy against the growth of state welfare benefits.[100] The 'respectable' working classes of the late 19th and early 20th centuries took pride in their financial independence, distrusted state hand-outs and distanced themselves from those who chose to rely on the charity of others.[101]

Even early generations of Fabian socialists were wary of the effects on personal autonomy and social character of an increase in state provision. Writing in 1912, shortly after the introduction of compulsory state health and unemployment insurance in England, the renowned Fabian, Hilaire Belloc, complained: 'A man has been compelled by law to put aside sums from his wages as insurance against unemployment. But he is no longer the judge of how such sums shall be used. They are not in his possession; they are not even in the hands of some society which he can really control. They are in the hands of a Government official.'[102]

Belloc predicted that the growth of the welfare state would provide economic security for working people, but only at the expense of their freedom and dignity. He foresaw 'a future in which subsistence and security shall be guaranteed for the Proletariat…by the establishment of that Proletariat in a status really, though not nominally, servile.' Depressingly, Belloc has been proved right.

By taking people's earnings away in tax, and then compensating them with welfare benefits and services in kind, politicians have ensured that people's basic needs for health care, income security, education and physical sustenance have been covered, but they have neglected what psychologist Abraham Maslow identified as their 'higher needs' for esteem (or self-respect) and 'self-actualisation' (or fulfillment of potential). Unlike food and shelter, these higher needs cannot be organized for us by politicians. Self-respect has to be earned by 'measuring up' in the eyes of others, and a sense of self-worth comes only from accepting responsibility for ourselves. As Charles Murray observes: 'The threshold condition for self-respect is accepting responsibility for one's own life, for which the inescapable behavioral manifestation is earning one's own way in the world.'[103]

By reducing people's responsibility for their own lives, the welfare state unintentionally undermines this ability to gain self-respect. Welfare professionals tacitly acknowledge this when they worry about the 'stigmatising' effect of welfare. They try to counter this by encouraging people to think of government hand-outs as a 'right', or by redefining claimants as 'clients' or even as 'customers, but nobody is fooled by these sleights of hand. Real clients pay for a professional service, they don't come cap-in-hand looking for assistance. And real customers spend money, they don't get given it out of money other people have worked for.[104]

No matter how much the dependency relationship is redefined or relabelled, it is impossible for people to retain self-respect if they are contributing less to the world then they are withdrawing from it. Depending on the government to give you what you need is inherently disempowering and dispiriting.[105]

Social policy intellectuals often make excuses for people who depend heavily on government hand-outs, arguing their plight is not their fault, and that others have a duty to support them. As the President of one welfare charity insists: 'The fault does not lie with the individual. It lies with the inability of the market to reach and sustain acceptable levels of economic participation for disadvantaged Australians'[106]

But the fact that neediness is not *always* the fault of those who suffer does not mean it is *never* their fault. Representing welfare claimants as 'victims' is hugely damaging in the long-run, for it encourages people to believe they have an unconditional 'right' to be supported by others irrespective of how they themselves behave. We can accept that some people encounter more problems and obstacles in their lives than others, but this does not mean we can or should absolve them from the sorts of responsibilities commonly expected of everybody else. Discussing welfare dependency among Indigenous Australians, for example, Noel Pearson observes: 'There is a behavioural dimension to work and disadvantage… personal responsibility and obligation are key elements that are corroded by long-term dependency… we now have a significant entrenched behavioural problem.'[107]

Dependency on the government not only erodes self-esteem; it also undermines what Maslow called the need for 'self-actualisation.' Self-actualisation involves achieving something through our own efforts. Human beings can lose heart when faced by challenges that are too big for them, but we become dull if life becomes too easy and all the challenges are removed. Yet the defining logic of the welfare state is precisely to make things easier for people by taking the challenges away: 'The purpose of most social policies is to reduce a difficulty, lower a barrier, or insure against a risk.'[108]

Because the modern welfare state constantly anticipates problems and compensates failure, it ends up removing responsibility and control from individuals and households. This is precisely what Theodore Dalrymple was getting at in the quotation at the head of this chapter, where he complains that the modern welfare state leaves many people with little or no purpose in their lives beyond 'sex and shopping.'

The welfare state does not trust us to determine things for ourselves. Government insists on providing the health care it thinks we need, the schools our children must

attend, the retirement pensions it does not believe we will save for ourselves, and the risk insurance it assumes we are too irresponsible to organize. The result is what psychologists call 'learned helplessness.' Whenever a problem arises, or a desirable objective goes unmet, we automatically turn to the government to do something about it, rather than working out how to tackle it ourselves. This is undermining one of the core conditions of human happiness and satisfaction. As Murray puts it in his latest work, 'The welfare state drains too much of the life from life.'[109]

This does not mean we should immediately strip away all the financial supports that the welfare state has put in place. Maslow's 'basic needs' for material subsistence and personal security still have to be met before the 'higher needs' for self-respect and self-actualisation come into play. The point, rather, is that genuine welfare should offer support to people in such a way that they can take responsibility for providing for themselves (and, indeed, for contributing to the wider society), rather than disempowering them by solving their problems for them. Traditional charities always understood this, but the modern welfare state has forgotten it.[110]

Reason (5): Social disintegration

If you strip people of the responsibility for looking after themselves, you should not be surprised if they become increasingly irresponsible in the way they behave. A number of commentators have recently identified links between the expansion of the welfare state and the growth of incivility and antisocial behaviour.

In Britain, James Bartholomew claims the welfare state has encouraged cheating and lying by claimants, that welfare support for lone parents has encouraged men to disown responsibility for their own children, that state schooling has fostered alienation and delinquency among disenchanted youths, and that state housing has created ghettoes of crime and incivility. In similar vein, British Labour MP Frank Field suggests that 200 years of progress in building civility in Britain has been unraveling because of the damaging impact of the principle of an unconditional right to welfare: 'The unconditionality of much welfare has severed the connection between a person's actions and accepting the consequences of that pattern of behaviour.'[111]

These disturbing insights challenge half a century of social policy orthodoxy. Defenders of the welfare state have long insisted that it strengthens our ties to each other and underpins the sense of responsibility we all owe each other. They believe that the inter-generational lending and borrowing that flows through the system (what we have called 'lifetime churning') binds us all together in a reciprocal network of give-and-take. Because everyone is tied into the system, the welfare state is said to generate a high level of social solidarity and cohesion which would fragment if individuals were left to manage their own affairs.

Australian economist and former political adviser, Michael Keating, is one of many Australian commentators who buys into this line of reasoning. He accepts that many people could cope financially if the welfare state were wound back and taxes were lowered, but he argues this would exact a high price sociologically: 'Members of our society are interdependent and have a mutual obligation to each other. In such a society collective or social goods and services make an important contribution to

wellbeing. The contention is these services should be available to all, and as far as possible universally used in order to maximise social inclusion and cohesion.'[112]

This is a common view among our social affairs intellectuals, yet there is absolutely no evidence demonstrating that high taxes and high levels of welfare spending do contribute to solidarity and 'social inclusion.' Indeed, such evidence as exists suggests the reverse is probably true—that the welfare state tends to undermine cohesion, just as Field and Bartholomew claim it does.

The reason, as sociologist Peter Berger points out, is that cohesion in social groups develops from the bottom-up, not the top-down.[113] A sense of common identity and mutual empathy is most unlikely to develop as a result of state bureaucracies reallocating tax revenues from one group of citizens to another. Indeed, if you stop to think about it, forced redistribution of people's money and assets is much more likely to be a recipe for resentment and petty jealousies than for fellow-feeling and solidarity.

A sense of common purpose, shared identity and collective responsibility does not come from receipt of government largesse but from the self-activity of what Edmund Burke called the 'little platoons' of civil society. It emerges when families, workmates, neighbours or friends come together in formal or informal organisations and networks to solve their common problems through cooperative activity. But the welfare state has taken over the traditional responsibilities of families and small communities leaving them with nothing to do for themselves.

Charles Murray demonstrates how devastating this has been with his review of philanthropic activity in New York City. A survey of 112 Protestant churches in Manhattan and the Bronx at the start of the twentieth century discovered they were between them organising 48 industrial schools, 45 libraries, 44 sewing schools, 40 kindergartens, 29 savings banks, 21 employment offices, 20 gyms and swimming pools, 8 medical dispensaries, 7 full-day nurseries and 4 lodging houses. This inventory refers to just one denomination of churches operating in just two of the five boroughs.

But this self-activity disappeared. It was choked off by the expansion of government provision. What need is there for voluntary schools, employment services, sports facilities and childcare if government organises these things for us?

Another example of how the expansion of government has 'crowded out' voluntary self-provision, philanthropy and mutual assistance is the way the friendly societies were undermined throughout the English-speaking world by the intervention of western governments into health care and risk insurance. Introduction of state-run health insurance before the First World War effectively destroyed the medical clubs in Great Britain;[114] the New Deal dealt a heavy blow to the fraternal lodges in the US in the inter-war period;[115] and government funding of doctors undermined the friendly societies in Australia after World War II.[116] In all three countries, cooperative organisations which had been a major source of community strength (what policy wonks today refer to as 'social capital') were killed off by the coming of the welfare state.[117]

We only have to look around us to see the fallacy in the idea that high government welfare spending brings social harmony. If we measure social cohesion with statistical indicators like crime rates, rates of substance abuse, suicide rates and rates of depression and mental illness,[118] then we find that most of these indicators have been increasing alarmingly over the last 30 or 40 years at precisely the same time as welfare expenditures have been growing most vigorously.

In Australia, the incidence of serious crime (perhaps the best single indicator of social fragmentation) has risen more than six-fold in the 40 years since the early/mid-1960s, yet this was precisely the period when government welfare spending was rising fastest.[119] It is much the same in New Zealand and the UK where greater equality and higher welfare spending went hand-in-hand with *more* crime and social fragmentation, not less.[120] Many of those who have been committing these crimes are in receipt of welfare benefits, which casts even more doubt on the theory that welfare makes people feel they are part of a larger social family. In New Zealand 4,600 of the country's 6,000 prison inmates were on benefits before they got locked up.[121] As an insurance against crime and disorder, it is clear that welfare has failed.

Just as increased welfare does not reduce crime, so reducing welfare does not increase it. American states dramatically cut back welfare spending throughout the 1990s, yet their crime rates plummeted. Between 1989 and 2000, the proportion of Americans reporting they had been victims of assault fell by more than one-third and the proportion reporting they had been burgled was halved. The number of robbery victims dropped three-fold, and there was more than a four-fold drop in the number reporting their cars had been stolen.[122] These remarkable results made a mockery of the dire warnings issued by American critics of welfare reform who had warned that it would trigger a new crime wave.

Given all this evidence, it is difficult to understand how social policy experts can still see higher welfare spending as the route to a stronger, safer and more 'civilised' society. Yet most of them continue to insist that welfare buys harmony and consensus, even though the evidence points decisively in the opposite direction.[123]

Reason (6): Politicisation of civil society

As increasing numbers of people have come to rely on the government to provide them with an income or to deliver them with services, so everyday life has become increasingly politicised.

Stripped of many of their traditional philanthropic functions, the welfare charities have metamorphosed into vociferous research and campaigning bodies. Drawn by the lure of billions of dollars up for grabs each year, pressure groups compete to win the ear of spending ministers and taxpayers jostle to ensure they get their 'fair share' of government spending. Voters learn to regard government as a huge cash-dispensing machine, casting their votes for whichever party promises to give them the most money, and responding to policy initiatives solely on the basis of how much cash is being diverted to them. Increasingly, we all learn to look to Canberra to solve the problems in our lives rather than sorting them out through our own initiative and enterprise.

Caught in the middle of all this, politicians get drawn into an unseemly electoral competition every three years, each party outbidding the other with spending promises aimed at this or that section of the electorate. Nobody has the courage to risk alienating voters by turning down their demands for more, still less by explaining that all these demands for more health spending, bigger education budgets, more generous family payments, bigger age pensions or an expanded child care system can never possibly be met, for a population trained to expect something for nothing will never be satisfied.

The more government does, the more people's expectations get driven upwards. As Anthony de Jasay dismally observes, 'The beast must be fed *continually*.'[124] It is this political ratchet effect that has created and nurtured tax-welfare churning.

Each new demand is headed off by new expenditure targeted at whichever specific section of the population is making the most noise or wielding the most votes—single parents, working families with young children, age pensioners, people with health problems, students, apprentices, carers. The cost is then spread thinly, almost imperceptibly, over everybody else. And when another group starts agitating, it too is bought off, and again, everyone pays a bit more tax. In the end, things come full circle as each group winds up paying for each other group's benefits: 'As the bias of the system is such that the state tends to say at least a partial "yes" to the bulk of them, the major result is bound to be churning. *Both* Peter *and* Paul will be paid on several counts by robbing *both* of them in a variety of more or less transparent ways.'[125]

The major factor driving this perpetual expansion of government is the welfare state. We saw in chapter 1 that the welfare state is now the core business of government. It soaks up two-thirds of all the revenue collected by federal and state governments, it employs one-fifth of all Australians who have jobs, it educates two-thirds of the nation's children, it provides full medical cover for the 60% of households who eschew medical insurance, it provides the sole source of income for one in six working-age adults, and it supports more than half of the retired population who have no other source of income than their age pension. This is quite a constituency, and it helps explain why the mass welfare state is proving so difficult to dismantle, even though it has outlived its usefulness.

Every year the welfare state keeps growing despite the increasing potential for the population to look after itself. It has become an established part of our society, and decreasingly few of us remember a time when it was not there giving us things. Over time, people have adjusted their behaviour to take account of the new balance of risks and responsibilities created by large-scale state intervention in their lives. Several generations have grown up expecting the government to pick them up and bale them out if they behave foolishly or if things go unexpectedly wrong in their lives, and this has enabled or even encouraged foolish and ill-advised behaviour to flourish. The result is that increasing numbers of people have come to depend on the services which the government put in place to help people who behave foolishly.

People stop saving for their old age, for example, for they know the age pension will provide them with an income when they get older provided they have no money of their own. They do not bother to insure against ill health because the government says it will provide free hospital care if calamity strikes those who have made no provision

for themselves. People who engage in self-destructive behaviour know they will not have to bear the consequences of their actions. Drug users whose habit renders them unemployable know they can still get an income from the government even if they keep using drugs. Men who father children they do not want know the government will support their families if they abandon them. In these, as in so many other ways, the welfare state creates and reproduces the very problems it was intended to resolve. It is forever playing catch-up.

Prospects for radical change

Despite the political vote-buying by governments and the learned helplessness of those who have come to depend upon its hand-outs, there is one powerful trend that is gradually chipping away at the foundations of the mass welfare state. This is the rising level of affluence in the population. As people get better off, so they are withdrawing in increasing numbers from what the government is offering them and are choosing private sector alternatives instead. The nail in the coffin of the mass welfare state is rising prosperity.

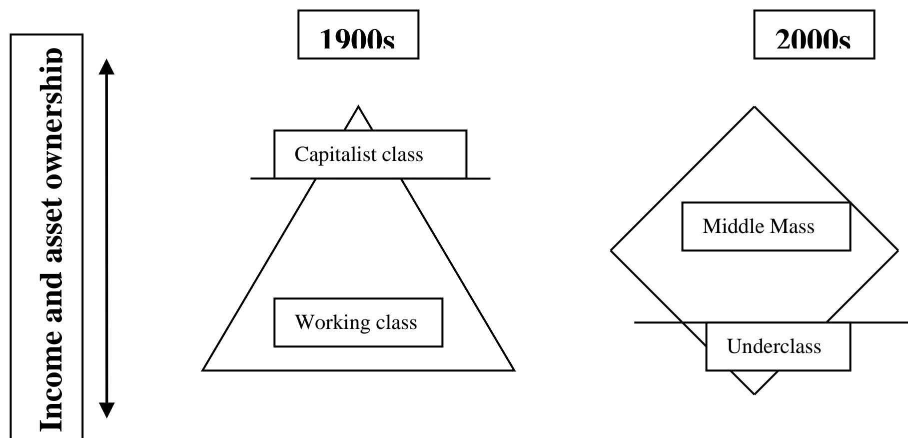
Rising prosperity raises expectations and lifts the standards which service providers must meet if they are to attract customers. The mass welfare state is already struggling to keep pace with rising costs and it cannot hope to satisfy the growing demands that are being made of it. The level and quality of services it provides may have been adequate in the 'mass society' era of the 20th century when consumers were happy just to be given a basic minimum service. But people are not prepared to accept a mass production line welfare state any longer, and growing affluence enables more and more of them to buy what they need rather than accept what they are given by their governments. Increasing numbers of 'aspirational consumers' are exiting the system, even though it means they have to pay twice.[126]

About 40% of the population is covered by private health insurance, for example, and although they can recover part of the cost through a tax rebate, they still end up paying a lot more for their health care than they would if they were content just to rely on Medicare. Similarly, more than one-third of parents now send their children to non-government, fee-paying schools. Again, the fees they have to pay are reduced by federal government subsidies to the non-government sector, which has brought the private alternative within reach of many more parents, but they still end up paying a lot more than they would if they were content to consign their children to the public school system.[127] In both health and education, the switch to private alternatives has been enabled by government policies, but this is not the primary cause of it.[128]

The real explanation lies in the changing social structure. When the welfare state first began to emerge in western capitalist democracies, the majority of the population earned little and owned even less. The socio-economic structure at that time resembled a triangle in which a large number of people with very little clustered at the bottom while a small number of wealthy people sat at the top. If the masses at the bottom of this triangle were to be adequately housed and educated, kept in reasonable health and looked after in retirement, it would take a mass government system to do it.

But in the century that has passed since then, this triangle has been transformed into a diamond shape in which the mass of the population sits in the middle of the income and asset distribution (Figure 3.1). Not only have real wages and salaries increased enormously, but it has become normal for ordinary people to own substantial assets—houses, shares, superannuation portfolios—and to pass them on to the generation coming up behind them.

Figure 3.1: The changing socio-economic structure



The fundamental division identified by Marx, between a small class of owners of capital and a huge propertyless class which has only its labour power to sell, has dissolved. In today's era of 'popular capitalism,' the biggest owners of share capital are financial institutions like superannuation funds and insurance companies, but their assets are owned by millions of ordinary workers.[129] Today, most of us work for a living (Treasurer Peter Costello was in this sense right when he claimed recently that we are all 'working class'),[130] but most of us also own (directly or indirectly) the capitalist enterprises that employ us. Capitalism has democratised and universalised itself, turning the mass of the population into both workers and owners of capital. In the language of Marx's dialectic, the capital-labour contradiction has synthesised into a 'middle mass' of owner-workers.

What has replaced the old capital-labour class division is a growing polarisation between this 'middle mass' of the population, which is sharing in the country's growing prosperity through active participation in the labour market and the gradual accumulation of assets like housing, shares and superannuation, and a marginalised 'underclass' with a peripheral attachment to the world of paid work and virtually no wealth or assets.[131] The key social division in the 21st century is shaping up to be that between a self-reliant, property-owning middle mass and this marginalised underclass, and it is the latter that still depends almost wholly upon the state for its sustenance.

The socio-economic transformation identified in Figure 3.1 is undermining the welfare state, for today we have a 'mass' welfare state which no longer corresponds to

the needs and aspirations of the 'mass' of the people. Defenders of this outdated system, worried that it is collapsing, want to stop the 'middle mass' of the population from escaping into private provision. To do this, they want to lock them into continuing state dependency by increasing their taxes, thereby forcing them to pay for state services they no longer want. As one leading social policy intellectual explains: 'It is the taxes of the middle classes that ultimately provide most of the revenue on which the welfare system depends, and it is therefore necessary to give the middle class a stake in the welfare system by extending its benefits to them.'[132]

Churning, in other words, is the price that social policy conservatives are willing to pay in order to maintain middle-Australia's support for the high-spending, mass welfare state. Quite brazenly, they hope to bribe the mass of voters with their own money, buying their support for a welfare state they do not need by shovelling more and more benefits and services in their direction. Happily, however, this is a policy which is almost certainly doomed to fail in the long term, for it is swimming against the tide of social and economic change.

A welfare state whose original purpose was to deliver security to people who could not achieve it for themselves is now being defended by forcing people to pay for schools they do not want their children to attend, and by imposing a health care system they never intend to use. The welfare state has gone from providing people with resources they do not have, to taking resources away from people in order to stop them from achieving their own independence and self-reliance.

But the advocates of coerced welfare are fighting a losing battle. The greater the number of people who shift from public sector to private sector provision, the more this momentum is strengthened as those left behind come to realise that it is possible that they too could get something better than what they are being given. The more the mass welfare model crumbles, the harder it becomes to shore it up.

The key question for 21st century policy experts should not be how stop people switching into the private sector (the question that has been preoccupying them for the last 20 or 30 years), but how to manage the transition from a mass welfare state to a system of self-funding while ensuring that the marginalised minority is not excluded from access to basic services. This is the question we shall address in Chapter 4.

Conclusion

Like the Old Man of the Sea who implored Sinbad to help carry him across a stream but who then refused to get off his back, the welfare state started out as a reasonable and manageable strategy for relieving hardship, but has become increasingly onerous and parasitic on our whole society. The people it was originally intended to help are now among its principal victims, prevented from exercising the autonomy and personal responsibility that should come with growing affluence because of the amount of money the government takes away from them to fund its continuing commitment to an outmoded, one-size-fits-all, welfare state model. The longer this is allowed to continue, the bigger the problem becomes.

The policy challenge in the next 20 years will be to extend opportunities for self-provisioning from the middle mass (who will seize them anyway) to the marginalised

minority (who will otherwise get left behind relying on a declining, second-class state sector). It is time we stopped defending the indefensible and started to think seriously about how to get the welfare state off our backs.

CHAPTER FOUR: SECURITY WITH RESPONSIBILITY

> *"Put baldly, the welfare state is out of control. The Coalition government has taken over more and more of the responsibility of running the daily lives of Australians, taxing them only to give the money back as cash payments and in services that they could have arranged for themselves'*
>
> Craig Emerson, 'Vital Signs, Vibrant Society' (2006)[133]

Any attempt to reform the twentieth century welfare state to make it fit better with twenty-first century social conditions will need to achieve two key objectives:

- It must ensure that everybody has the means to maintain themselves and their dependents at a reasonable standard;
- It must maximize the degree of control that people can exercise over their own lives by enhancing their scope for self-reliance.

The problem with the twentieth century welfare state was that it pursued the first of these priorities at the expense of the second. Indeed, the mass welfare state was built on the assumption that these two objectives were essentially incompatible and that the first precludes the second. This meant that the desire to ensure a reasonable standard of living for everyone was pursued through repeated extensions of government's powers and responsibilities at the expense of people's capacity to run their own lives.

The result, as we have seen, was a system intended to care for people by taking huge amounts of money away from them and spending it on services that politicians and welfare professionals thought they should have. This self-defeating logic meant that millions of people who could otherwise have been self-reliant were forced to rely on government instead. Rather than overcoming neediness, the welfare state unintentionally created and reproduced it on a massive scale as even the middle classes were eventually locked into escalating levels of state dependency.

The good news is that none of this is necessary, for in an era of mass affluence, the two principles of security and personal responsibility need not be incompatible. But to get the best of both worlds will require a fundamental rethink of the welfare state institutions we have inherited from the past.

Guaranteeing security

In a world where even the middle classes have become habituated to dependency on government, any radical blueprint for reform of the welfare state will inevitably create anxiety among those who have lost the habits of self-reliance. The academics, public sector unions, welfare lobby groups and others who support (and depend for their livelihoods upon) the existing state system of welfare know this, and they play on these public anxieties whenever any reform is mooted. Reform ideas constantly get derailed by hysterical claims that they will result in poor people suffering, or in standards of provision falling, or in people being left alone to cope with their own problems with no help from the wider community.

To counter claims like these, it is important at the outset to identify an unambiguous set of minimum criteria for personal security which any new system for organizing welfare must satisfy. We can do no better in this regard than to reiterate the four ‘bottom line objectives’ identified by the former Labour Finance Minister of New Zealand, Sir Roger Douglas, in his recent work on welfare reform:[134]

- Anyone who is sick should get treatment when they need it, whether they can afford it or not;
- All children should get a first rate education, whether their parents are rich or poor;
- Every person should be able to retire on an adequate income, whatever jobs they have done during their working lives;
- When people of working age are unable to work for reasons such as unemployment, sickness or accidents, they should have access to money.

The ‘bottom-line’ requirement is that the level and quality of support should be no worse under any future arrangements than it is under the existing system (hopefully, of course, it should be a lot better). Given the huge sums of money that now swirl around the system, and the growing inadequacies apparent within it, this should not be a difficult condition to fulfill.

The first two of Douglas’s bottom-line objectives are currently met through direct government provision of services—public hospitals, public health insurance (Medicare), public schools, and so on. But we saw in Chapter 3 that, as the population ages, state health care systems have come under mounting pressures which have been made worse by the escalating costs of new treatments. Unless they opt out of the state system by buying private insurance, there is no way people can currently exercise a choice regarding the level of treatment they want or the proportion of their income they want to devote to their health care needs. Similarly in education, government schools are proving less and less capable of delivering the type and quality of education that parents want, which is why more than one-third of Australian parents now place their children in the private sector instead.

The latter two of Douglas’s objectives are currently organized through the system of government cash transfers—a means-tested age pension for retired people, and a system of conditional cash welfare benefits for those of working age. But the basic government age pension discourages people from saving for their own retirement, and the income support system for working-age people has fostered a welfare-dependent underclass and encouraged rather than rectified the kinds of behaviour that result in neediness.

It should be possible to re-think the way people achieve access to health care, educate themselves and their children, and secure their future income security in such a way that they end up better off than they are under existing arrangements *and* enjoy greater control and responsibility for their own lives. In this chapter we review various ideas about how this might be done.

A Negative Income Tax (NIT)

The idea of a Negative Income Tax was put forward almost fifty years ago by Milton Friedman as an alternative to the existing welfare payments and benefits system.[135] Friedman suggested that in place of the existing array of welfare transfers, a guaranteed basic minimum income should be delivered through the tax system. Just as anybody earning above the tax-free earnings threshold (TFT) pays a given proportion of their additional income in 'positive tax,' so anyone earning below it could be topped up at a given rate with a 'negative tax.'

For example: If the TFT were set at $10,000 per annum (that is, no-one pays tax until they have earned $10,000 in any year), and the rate of NIT was fixed at 50%, then anybody earning below $10,000 would not only pay no tax, but would under this scheme receive a 'negative tax' payment worth half of the shortfall. Those earning $5,000, for example, would receive a $2,500 top up; those earning $1,000 would receive $4,500; and those with no income at all would receive the maximum $5,000. All other government payments would be scrapped.

Friedman claimed a number of advantages for this proposal. He thought a NIT would be cheaper than the present 'rag bag of measures,' and he was confident that it would prove much more efficient to administer. Provided the level of the TFT and the rate of NIT were set appropriately, nobody would fall below an acceptable minimum level of income, and the system would be a lot simpler than the existing targeted benefits. Because it would be administered as part of the tax system, it would also overcome the problem of tax-welfare churning and the high Effective Marginal Tax Rates that go along with it. With a NIT rate of 50%, nobody would lose more than 50 cents in each additional dollar earned, no matter how much or little they worked, for liability for income tax would not begin until eligibility for receipt of NIT had fully tapered off.

Friedman did recognize some problems, however. He worried that, like any other system of tax-funded subsidy, NIT might over time become increasingly generous to increasingly large numbers of voters (the problem of the growth of middle class welfare): 'There is always the danger that instead of being an arrangement under which the great majority tax themselves willingly to help an unfortunate minority, it will be converted into one under which a majority imposes taxes for its own benefit on an unwilling minority.'[136] There was also the possibility that a NIT might be introduced alongside other existing welfare benefits, rather than in place of them, thereby expanding the scale and scope of state provision rather than curtailing it.

Friedman could see no guarantee against these dangers other than relying on 'the self-restraint and good will of the electorate.' This is a worry, for self-restraint has been in short supply over the last forty or fifty years as welfare expenditure in Australia has escalated.

An additional problem noted by Friedman was that payment of a NIT would inevitably create some work disincentives: 'Like any other measures to alleviate poverty, it reduces the incentives of those helped to help themselves.'[137] However, he hoped that most poor people would prefer to become richer by working than to settle for a life on a minimum subsistence income, and he thought a 50% abatement rate would not unduly deter them.

As things turned out, however, this assumption proved overly optimistic. NIT experiments in the USA during the 1970s found the offer of even a low guaranteed minimum income was enough to dissuade significant numbers of people (especially young males) from working. Introduction of NIT payments increased the likelihood that people would become or remain unemployed, it reduced their search for work and it slashed the number of hours they were willing to work each week. It also had deleterious effects on the stability of family life.[138]

Many of these experiments offered a more generous payment than was envisaged in Friedman's original proposal, but this only points to a third serious problem with his NIT idea—the issue of political feasibility. In his later writing,[139] Friedman noted that any welfare reform has to meet three conditions simultaneously if it is to stand a serious chance of implementation: it must preserve work incentives, it must provide an acceptable level of support for claimants, and it must not involve significant additional expenditure.[140] But if payments remain as generous as under existing arrangements, introduction of a NIT will massively increase costs unless a steep taper is introduced, in which case work incentives are likely to suffer.

Consider Friedman's updated (1980) proposal for a 50% NIT based on a TFT of US$7,200 per annum (the tax-free income as it stood in 1978). A 50% taper would, he believed, be enough to maintain work incentives, and the total cost of his scheme would be less than the current system of benefits was costing. But a 50% NIT on a base of $7,200 meant that claimants with no other income would end up with just $3,600, far below the welfare minimum at that time (a family of four was getting around $6,000). His proposal therefore met two of his three reform requirements (incentives and cost), but it fell at the third (adequacy of benefits). No government would dare do it.

To get around this, the guaranteed minimum pay-out could be raised to match the existing welfare payments level of $6,000. But this would require an 83% taper if NIT were still to phase out at the TFT of $7,200. The prospect of losing 83 cents of every new dollar earned would certainly dissuade a lot of jobless people from taking work. The only way to overcome this problem is to reduce the taper rate by pushing the value of the TFT higher (a TFT of $12,000 would enable a 50% NIT rate)—but this would massively increase the total cost of the scheme.

The same dilemmas that dogged Friedman's NIT scheme continue to haunt the welfare reform debate in Australia. Some reformers concerned about the strong work disincentives (high EMTRs) in the our welfare system have proposed reducing means test tapers or introducing tax credits to boost the take-home incomes of workers in part-time and low-paid jobs, but proposals like these invariably involve either higher costs or lower benefits.[141] Resolving this problem is the equivalent of squaring the circle.

A Negative Income Tax with a high Tax-Free Threshold

A provocative variant of Friedman's NIT proposal was recently proposed in Australia by John Humphreys. His self-styled '30/30' scheme involves a very high TFT of A$30,000 per year with a flat tax of 30% on any income earned in excess of this amount, and a NIT of 30% paid to anybody earning below it. The NIT would replace

all existing welfare and family payments, and all existing tax concessions would also be scrapped.

Humphreys's proposal squarely tackles the issue of work incentives. It has been clear for a long time that our over-complex and burdensome tax system is eroding work incentives, and this is compounded at the lower end of the income distribution by a tightly means-tested welfare system which sharply withdraws benefits as soon as people begin to take responsibility for earning their own money. The combined effect is that people can lose three-quarters or more of every additional dollar they earn (that is, they face an 'Effective Marginal Tax Rate' of 75% or higher), for as they move from welfare dependency into self-reliance the welfare system claws back means tested benefits at the same time as the tax system levies income tax.

We shall see in Chapter 5 that the only real solution to this is to disentangle the tax and welfare systems so that no worker receives welfare at the same time as he or she is paying tax, and no claimant pays tax at the same time as he or she is receiving welfare. Humphreys's '30/30' reform achieves this, for people earning above the $30,000 threshold pay tax at 30% while those below it receive NIT top-ups of 30%. Nobody pays tax at the same time as they get top-ups, so nobody loses more than 30% of the next dollar they earn.

A reform like this would undoubtedly strengthen work incentives by reducing tax-welfare churning and slashing EMTRs. It would also make for a much simpler, more transparent and less dishonest tax/welfare system. It offers potentially huge efficiency gains by stimulating economic activity while cutting back on administration and compliance costs. The minimum wage could be scrapped (for NIT would top-up low wages, and Humphreys calculates this alone could stimulate the creation of up to half a million new jobs.

But the proposal encounters the same sorts of problems that dogged Friedman's original NIT reform. Humphreys tries to avoid a massive reduction in basic welfare incomes by opting for a very high TFT of $30,000. At a 30% NIT rate, this would guarantee a minimum income of $9,000 for people reliant wholly on government support. But even this is still substantially below what the current system guarantees a single person (around $13,000 when all benefits are included). And for those with dependent children, it would represent a huge cut (Humphreys opposes enhanced payments for families on the grounds that people who have children should pay for their upkeep themselves).

Raising the tax-free threshold to $30,000 would also take a huge bite out of the Federal Government's current revenue (and cutting marginal rates to a flat 30% would slash revenues even further). The modest 30% taper rate would also increase current levels of spending on top-ups to many working families (the disposable income of a minimum wage earner, for example, would rise by 31% due to increased government transfers). Humphreys claims that, over the medium term, the changes he proposes could pay for themselves through increased rates of workforce participation, but this is debatable, and he expresses impatience with those who insist that any reform must be revenue-neutral. But these arguments are unlikely to cut much ice with politicians.

The same nagging concerns about political feasibility that plagued Friedman's

original proposal thus arise here too, for households with no other source of income would be worse off under this scheme despite a likely increase in costs. This combination is unlikely to commend itself to politicians.

A Guaranteed Minimum Income (GMI)

Both the Friedman and Humphreys NIT proposals offer a guarantee of a basic income for anyone who does not work, with a graduated means test on top of that until the TFT is reached. A different approach, which avoids any means testing, would be simply to give *everybody* a basic, minimum income (whether they work or not), and to tax everybody on their combined income (what they earn plus what they are given by the government).

This has long been a favoured idea among socialists who see it as a way of scrapping conditional welfare payments (for it gives everyone an unconditional right to an income) and of weakening the link between receipt of income and the performance of paid work.[142] Liberals and conservatives, by contrast, have not generally favoured Guaranteed Minimum Income (GMI) schemes for precisely the reason that socialists are drawn to them: they entail government giving money for nothing to everyone unconditionally. They see the growth of dependency in the current welfare benefits system as bad enough, without extending it to the whole population.

This opposition has, however, begun to change following the publication by American libertarian thinker, Charles Murray, of a book advocating the introduction of an unearned, universal, basic income.[143] As we saw in chapter 3, Murray's previous work has been coruscating in its analysis of the ills of money-for-nothing welfare payments, and for thirty years he has been exposing the failures of state welfare and spelling out the moral argument for rolling it back. Yet having demonstrated that the welfare state does untold damage, and having concluded that the solution is to get rid of it, Murray now suggests in his latest book that everyone should get a government welfare payment as of right.

This change of heart follows Murray's recognition that politicians would never dare follow through on his advice simply to scrap welfare. Accepting that governments will never relinquish responsibility for ensuring people's welfare, he even accepts there is an ethical case for redistributing incomes to compensate those who are born unlucky. He also recognizes that modern America is rich enough to keep every one of its citizens out of poverty. 'For the first time in human history,' he says, 'there [is] enough money to go around.'[144]

Murray concludes that government can and should use taxes to help the poor, but that this should be done in a very different way than happens at the moment. Focusing his comments on the US, he argues that all existing welfare payments should be scrapped, government retirement pensions should be abolished and Medicare should be dismantled. All the money saved should then be used to give everybody over the age of 21 an annual payment of US$10,000.

The only conditions Murray would attach to receipt of the $10,000 hand-out are: (1) recipients must open a bank account; (2) $3,000 of the money must be spent buying health insurance (and if $3,000 is not enough, he is happy to increase the total size of

the hand-out to make up the difference); (3) the money cannot be accessed until the age of 21; and (4) up to half of the money will be clawed back through a tax surcharge once people start earning over $25,000 per year. He toys with a fifth requirement, that people should put some of the money away every year in a retirement fund (the equivalent of Australia's compulsory Superannuation Guarantee), but on balance he comes down against making this compulsory.

Murray's idea is superficially attractive, for it seems to meet both of the objectives for welfare reform laid out at the start of this chapter: it ensures everyone has enough money to maintain a basic but adequate standard of living, and it puts decision-making power in the hands of ordinary people rather than vesting it in governments. But on closer inspection, there are some major problems with it.

One relates to the familiar issue of costs. Murray claims that, introduced in America, his Plan would rapidly start to pay for itself, but his calculations are far from convincing when applied to the Australian case. For his Plan to work, it has to be possible to redirect current government spending in such a way as to guarantee that everyone would have enough cash in their pockets to get by. Peter Whiteford interprets this to mean that every recipient should get a payment equivalent to the existing age pension, but this means a guaranteed minimum income (GMI) paid to all Australians over the age of 18 would cost around $208 billion per annum (15.7 million people each receiving $512 per fortnight).[145] Currently, Centrelink spends about $63 billion on income support payments, including $15 billion of family payments, with another $2 billion spent on administration. The Department of Employment & Workplace Relations contributes another $3 billion. If all this spending were abolished, we would still have to find another $140 billion of savings out of total Commonwealth revenues of $220 billion.

Whiteford fails to take account of health savings in his calculations (for Murray wants the GMI to replace all government health expenditures). In principle, this would release a further $50 billion or so (see Table 2.1). Nor does he allow for Murray's proposed 'claw-back' of part of the universal payment as earnings rise. Nevertheless, even if these things were included, it is clear that the shortfall on current revenues would still be enormous. Whiteford suggests that a GMI for Australia would require a personal income tax in the region of 50 cents on every dollar earned to pay for it. He also points out that this would create even more churning than we see in our current system, for millions of workers would be receiving the basic payment while simultaneously paying tax on their earnings.[146]

There are other problems, too, with Murray's proposal. One is that his US$10,000 annual grant makes no allowance for family size and thus pays no attention to issues of horizontal equity (we saw the same is true of Humphreys's 30/30 plan for Australia). This means a childless couple gets $20,000, the same as a couple with five children. Murray claims that, provided they work, nobody need be in poverty—he calculates that a janitor, for example, would get above half the annual median income (a common 'poverty line' measure) after just 31 weeks of working. But what happens if the janitor has several other mouths to feed out of his income? Dependent children do not qualify under the Plan for any payment, and existing US family payments such as the child tax credit and Temporary Assistance for Needy Families (as well as the Earned Income Tax Credit for low-paid workers) are swept away. It is therefore

difficult to see how low income people bringing up large families could keep their heads above the poverty line (especially after they have paid for health insurance for all the family and put something away towards their superannuation). Despite his protestations to the contrary, rates of child poverty would almost certainly rise if Murray's Plan were adopted. [147]

Murray's Plan also generates some obvious problems regarding work incentives. He admits that income-testing the $10,000 payment with a 20% surtax on incomes over $25,000 would lead to higher effective marginal tax rates on low-to-middle income workers, but he denies that this would have a serious impact on work incentives, arguing that the income test taper only cuts in at a point where people would be reluctant to throw in their jobs. But as he is forced to recognize, they might very well cut back on their hours. Why accept overtime or take night classes to win a promotion if the result is that you start losing your $10,000 government payment as your earnings rise? This Plan would reproduce the problem of high EMTRs which is so familiar in our existing welfare system.

There is also the question of how people would react to the prospect of receiving a no-strings $10,000 annual payment from the government. Murray candidly writes: 'The Plan…says to twenty-one year olds, "If half a dozen of you want to pool your grants, rent a cottage on an inexpensive beach, and surf for the rest of your lives, the American taxpayer will support you."' [148] Murray hopes and believes that few will adopt this course, but this looks like wishful thinking. There is something very odd about a Plan that is intended to discourage dependency on government hand-outs but which ends up dispensing money unconditionally to anybody who chooses not to take responsibility for themselves.

What is really objectionable about Charles Murray's Plan is the impact a money-for-nothing lifetime government payment is likely to have on the way people start to think and behave. At a Washington Forum convened to discuss Murray's book, Jonathon Rauch expressed concern that rather than getting a job, 17 and 18 year olds might decide to 'hang out' for three years, selling drugs or bludging from relatives, waiting to retire at 21 on the government payment. He was right to be concerned, for if you offer people money for doing nothing, you will most certainly end up with more people deciding to do just that. Given everything that Murray has written down the years about the importance of self-reliance, it would be ironic if his lasting legacy to social policy turned out to be an unconditional cash payment enabling even more young people to waste away their lives by settling for dependency and idleness.

Personal savings accounts

Rather than simply giving people money, a better way of ensuring they have enough to live on (which would also transfer responsibility for their own lives back to them) would be to require them to save for their own future needs. Government funds could if necessary be used to top up savings, but everyone would be expected to set money aside from earnings to help meet their own future needs.

Australian workers are already required to put money aside (through their employer) for retirement savings, but people could also be asked to put money aside to meet the costs of their future health care, or they could be expected to build up 'rainy day'

savings to be used to replace lost earnings when they are sick or unemployed. Income sacrificed into these savings accounts might then be compensated by reducing the tax they have to pay (for if they reduce their demands on government provision, less revenue would need to be collected from them).

Some libertarians dislike compulsory savings and the strong element of state paternalism they entail. In their view, it is better to allow people the freedom to determine how best to spend their cash, even if this will inevitably result in some making bad or even disastrous choices. But leaving people to make their own mistakes raises the question of what is going to happen down the track when the rest of us see people in dire financial difficulties and come under intense moral and political pressure to do something to alleviate their suffering. Realistically, we are going to be called upon to provide aid for those who have failed to make provision for themselves (and for their dependents). It would therefore be better to ensure that everyone puts enough money aside for themselves in the first place.[149]

In Australia we are already familiar with the idea of compulsory retirement savings, for ever since 1992 employers have been required to pay a proportion of their employees' wages (currently 9%) into a superannuation fund which can only be accessed upon retirement. For all intents and purposes, this compulsory savings scheme is a deduction from wages, for although it is contributed by employers, it reduces the size of the wage fund which is available to paid out in salaries. Workers enjoy the right to determine which fund their employer contributions are paid into and they can decide what to do with the money when they draw it out.

Our system of compulsory superannuation savings is often cited as a successful example of how personal savings accounts can take pressure off state-funded systems by making individuals more responsible for their own welfare. Because of compulsory retirement saving, Australian government expenditure on age pensions is expected to rise by less than 2 percentage points over the next 50 years, which is three times less than the growth of projected spending in New Zealand, where there is bi-partisan agreement to retain a tax-funded age pension system.[150] But Australia was not the first country to go down this path, nor have we taken the idea as far as some other nations have taken it.

The trailblazer was Singapore which in 1955 established a compulsory retirement savings scheme under which workers and their employers were obliged to deposit a percentage of earnings into individually-earmarked accounts run by a government-managed Central Provident Fund (CPF). This original scheme has expanded in the last fifty years so that today, workers have to deposit 20 per cent of their gross earnings in the CPF (see chapter 3). These contributions not only go into their personal retirement accounts, but they also fund personal medical savings accounts ('Medisave'), which are used to pay for hospital expenses, and 'Ordinary Accounts,' which can be used for house purchase, education and other approved purposes. All deposits, withdrawals and interest earned are free of tax, but the government makes no further contribution. Funds administered by the CPF now amount to 60% of Singapore's GDP, and the scheme covers some 2.5 million wage and salary earners.[151]

In 1981, Chile followed Singapore's example by privatising its retirement pensions system, which was threatening to collapse into insolvency. As in Singapore, workers were compelled to pay a proportion of their earnings (minimum 10%) into a private account, but unlike Singapore, they could choose between as many as twenty competing fund management organizations (now down to just six). As in Singapore, the Chilean government does not contribute to these funds, but—unlike Singapore—it does use general tax revenue to make up any shortfall in people's accounts when they reach retirement age. By the turn of the century, total assets in these schemes had grown to 42% of Chile's GDP, and they were claimed to cover 95% of full-time workers.[152]

Neither of these schemes has been without its problems. In Singapore, withdrawals to pay for home ownership have depleted some people's accounts to a level which may be insufficient to purchase an adequate retirement annuity.[153] Nor do workers have any say over how or where their money is invested, for every cent goes compulsorily to the government-run Central Provident Fund.

In Chile, where workers do have a choice between competing private sector fund managers, high fees can soak up one-fifth or more of all the money deposited. Effective coverage, too, is patchy because unknown numbers of casual and temporary workers do not belong to any scheme. The architect of the reform, Jose Pinera, claims that age pensions are 40 or 50 per cent higher than under the old system, and that the future burden of taxation has been reduced, but there are reports that retirees are receiving lower incomes than they had been led to expect, and government spending on top-ups has remained high. Nevertheless, the average rate of return achieved by funds has been in excess of 10 per cent per annum, and the average saver retires on 78 per cent of their previous income. Furthermore, a huge pool of savings has been generated which has provided the investment capital needed to sustain rapid economic growth. In the mid-nineties, the savings rate in Chile was about 26% of GNP—almost double the South American average, and close to the level of the Asian tiger economies—and the economy was growing at an annual rate of about 6%.[154]

Singapore and Chile and not the only examples of the development of personal savings accounts. Argentina set up a system of private retirement accounts in the mid-1990s, allowing workers to transfer from the state system if they chose, and in 2000 Sweden allowed workers to use 2.5% of their payroll tax contributions to fund so-called 'premium accounts' which they manage themselves. Poland too introduced personal retirement accounts in 1999.[155]

Savings Accounts combined with insurance

With the exception of Singapore, most personal savings accounts introduced by governments around the world have been limited to funding retirement. As we saw in chapter 3, the ageing of western populations is threatening to bankrupt government-funded retirement schemes based on a pay-as-you-go principle, and this has fuelled interest in private savings as an alternative. But as the example of Singapore makes clear, there is no reason in principle why compulsory personal savings should not be used to help fund other provisions apart from retirement. After all, if people can save enough to pay for their own retirement needs, why shouldn't they also save to meet

the cost of less expensive lifetime expenditures such as health care or replacement income at times of sickness or unemployment?

One obvious problem with requiring people to save for their own health and income security needs is that nobody can possibly know how much money they will require in the future. Some people will end up saving more than they need, and others will inevitably end up requiring more than they could possibly be expected to save.

The first of these problems could be rectified by allowing savers to transfer surplus funds to other purposes (Singapore, for example, allows surplus health savings to be used for other purposes once people pass the age of 55). The second problem is, however, more worrying. What happens if somebody has a prolonged bout of sickness or unemployment and runs down all their savings? And what about those who require expensive medical treatment, the cost of which far exceeds what they have managed to put aside in a personal Medical Savings Account (MSA)?

Clearly health or sickness savings accounts would need to be backed-up by some sort of insurance system based on pooled risks. Such insurance could be offered by the government, but consumers would enjoy greater choice and flexibility if it were organised by private sector insurers. For example, workers might be required by law to accumulate funds in a MSA sufficient to meet everyday medical bills while insuring themselves against more expensive conditions. Charles Murray draws a parallel with vehicle insurance: 'Taking care of your health-care needs should be like keeping your car on the road. You pay for the ordinary upkeep with cash and use insurance to protect against expensive accidents.'[156]

Of course, relying on insurance to cover highly-expensive eventualities is itself not without problems. One is that, left to their own devices, people may under-insure. Nicholas Barr believes people find it difficult to assess their insurance needs when the benefits may be delayed a long time into the future (as with a retirement pension), or when they lack expertise (for example, in evaluating competing medical advice).[157] However, if people are given the responsibility for making their own choices, they are likely to make more effort to become better informed, and if they lack expertise, there are various agents to advise them. The history of the friendly societies shows that ordinary people with only a basic education are quite capable of looking after their own long-term interests and choosing which professional services they want without the state having to do it for them. If people nowadays appear incompetent to make these decisions it may be because the welfare state has made them so.

Barr also points to problems of 'market failure' in insuring against risk and uncertainty. There are certain kinds of risks that private insurers find it difficult to cope with (insurance pooling often breaks down, for example, as a result of high risk individuals seeking to over-insure while low risk ones decline insurance altogether), and there are some circumstances (inherited illnesses, for example) where people may find it impossible to get themselves insured unless government obliges companies to accept them. Private insurers also have to contend with problems of moral hazard (where individuals deliberately expose themselves to an insured risk in order to claim the benefits), although these obviously arise in state welfare systems too (for example, in the example of voluntary unemployment).

Problems like these require a continuing role for government, if not in providing insurance, then in regulating it. [158] Pooled risk difficulties may require laws insisting that everybody insure themselves up to a certain level (while nevertheless leaving the choice of insurer and comprehensiveness of cover beyond the basic level up to them). Similarly, to ensure that everyone can find affordable insurance, government would have to impose 'community rating' and 'guaranteed issue' conditions on the insurance industry (that is, there would need to be some cross-subsidy between healthy, young people and unhealthy older ones, and companies would have to accept all comers—the so-called 'taxi-rank' principle).[159]

There is also the problem of cost. Health insurance is expensive, even though it currently attracts a federal government subsidy. However, by including MSAs in the reform mix, health insurance could be made more affordable. This is because access to personal savings would enable people to agree to meet substantial excess payments (or 'deductibles') on any health insurance claims they make. This will significantly reduce the costs of the premiums they have to pay. In the USA, the health insurance industry estimates that increasing the size of the deductible by $1,300 reduces the annual premium by $500.[160] If every Australian had an MSA, therefore, they could probably afford to pay several thousand dollars excess, in which case catastrophic health insurance could be offered much more cheaply.[161]

Compulsory Medical Savings Accounts would also drive down the cost of many routine health care treatments and hence dampen down the alarming rate of increase in health spending.[162] In part this is because a system like this would be cheaper to administer. Following a medical or dental consultation, the patient could simply swipe their MSA card in much the same way as they might use any other debit card, and the transaction would be processed on the spot. This would be more efficient than having Medicare, or even private sector insurance companies, reimbursing small claims, for the administrative costs involved in this reclaiming procedure can often exceed the cost of the claims themselves.[163]

By making patients more conscious of the cost of their treatment or medications, MSAs would also encourage people to 'shop around' to find the best bargains, and this too would drive down medical bills. In South Africa, where a system of MSAs has co-existed with private health insurance since 1992, people with MSAs pay an average of 11% less for their prescription drugs than those who rely on health insurance alone. The reason is that they have a direct financial incentive to seek out the cheapest supplies.[164]

Heightened cost consciousness would also reduce unnecessary or trivial use of health care resources. The obvious concern here is that people might put their health at risk by trying to cut their treatment costs, but studies suggest this does not happen. In a US randomised trial, people using heavily-subsidised health plans achieved no better health outcomes than a group which had to meet more of its costs from their own pockets, and in South Africa, researchers found no evidence of MSA patients foregoing necessary treatment in an attempt to protect their savings.[165]

Health outcomes might even improve under a system like this, for the incentive to save money could translate into a desire to prevent health problems from occurring in the first place. In Singapore, where a comprehensive system of MSAs ('Medisave')

has been running since 1984, health costs have stayed remarkably low by international standards, yet health outcomes measured by indicators like the infant mortality rate are extremely positive.[166]

Could a system of personal accounts, backed up by compulsory catastrophic insurance and by safety net guarantees, satisfactorily replace Medicare in Australia? There would have to be strong guarantees that low income and/or chronically ill patients would receive adequate cover. But a system of personal accounts linked to catastrophic insurance could in principle offer low income people the chance to control their own health care for the first time since the friendly societies went into decline, and if the Singapore experience is any guide, it could make waiting lists in public hospitals a thing of the past. A system like this would also enable us to slow the rate of increase in health spending in the coming decades, for it should deliver high quality treatment at lower costs by making the final consumers responsible for at least part of the expenditure their treatment incurs.

Asset-based welfare—a step too far

In Singapore and Chile (and in Australia's Superannuation Guarantee scheme), individuals are obliged by law to save, but the government contributes nothing to their savings (although it does subsidise them through tax breaks). As the idea of encouraging personal savings has spread to other countries, however, the principle of compulsory participation has weakened, and support for government co-payments has strengthened. The result is that a number of governments have now introduced voluntary savings schemes with contributions funded by taxpayers.

These so-called 'asset-based welfare' schemes are very different from the personal savings accounts we have been discussing up to this point. They are based on the idea that it is better to enable poor people to build up capital, rather than giving them repeated cycles of welfare payments to supplement their incomes. Schemes therefore help low income people accumulate wealth in the hope of freeing them from dependence on more traditional, income-based welfare. Asset-building, in other words, is seen as a path out of dependency, unlike traditional income support which locks people into it.

Because poor people generally have insufficient spare cash to put aside in savings, most asset-based welfare schemes involve government putting taxpayer money into people's personal savings accounts to match or supplement money they deposit themselves.

In the USA, the 1996 welfare reform included a provision that allowed states to set up 'Individual Development Accounts' (IDAs) using federal welfare funding. IDAs are personal savings accounts for poor families which encourage people to save by matching their contributions with government contributions (either directly, or in the form of tax credits paid by government to the lending agencies). At the end of a specified period of time, the savings that have accumulated can be used for certain specified purposes such as a deposit on a house purchase, funding a small business, payment of post-secondary education fees, or a retirement annuity.

Only a minority of states established IDAs under the 1996 Act, although another 20 or 30 developed IDA initiatives of their own.[167] Two years later, the federal government had another go with the *Assets for Independence Act* which set out to create 50,000 new IDAs. In the event, only 5,000 actually got set up. This was in turn followed by the *Savings for Working Families Act* which envisions 300,000 new accounts being opened over seven years from 2004. Nevertheless, the OECD thinks less than 2 per cent of eligible Americans will be participating by 2010.[168] As of 2003, only 20,000 were participating in asset-building savings schemes, and most of these were people who had jobs, who were relatively well-educated, and who already had some experience of saving (for example, they had bank accounts).[169]

The American IDAs experiment has not, therefore, created the revolution its advocates might have hoped for. Nor has this idea fared any better in Australia. In the late 1990s, Mark Latham (who later, fleetingly, became Labor Party leader) advocated a raft of asset-building policies including extended superannuation, employee share ownership, grants and tax subsidies to encourage individual share ownership among low income groups, Lifelong Learning Accounts to subsidise fees for adult education and training, and 'Nest Egg' savings accounts for young people to build up financial assets with matching contributions from the government. In the event, none of this came to anything.[170] More recently, however, a modest, joint initiative by the ANZ Bank and the Brotherhood of St Laurence has been offering dollar-for-dollar matched savings accounts to a small number of low income families in Victoria, and evaluations suggest this non-government scheme has produced some positive outcomes.[171]

Things have gone much further in Britain. Despite a catastrophic early experience with 'Lifelong Learning Accounts,' in which millions of pounds were defrauded from taxpayers, the Blair government has enthusiastically embraced the principle of asset-based welfare.[172] Its flagship policy is the 'Child Trust Fund' which provides *every* new-born child with a taxpayer-funded lump sum as well as offering further, means-tested matching payments for children of poor parents. This is complemented by a 'Saving Gateway,' a new system of family savings accounts in which deposits made by low income households are matched pound-for-pound by government contributions.

In both of these initiatives, the original idea was that account balances should only be spent on approved purchases such as the deposit for a house, an adult education course, or the establishment of a small business. However, after the UK Treasury concluded it would be impossible to police the way funds get used, all restrictions on how the money is to be spent were scrapped.[173] This means British taxpayers are now required to hand cash to other people's children who at eighteen can spend it buying a motorbike, backpacking in Bangkok, or throwing a lavish Coming-of-Age party.

The UK Labour government describes these savings schemes as a major innovation in social policy—"a different way of looking at the welfare state."[174] As in America, however, they are not intended to replace any existing elements of the state welfare system. Indeed, rather than reducing welfare dependency, they have been promoted as a novel way of extending the welfare system into new areas: 'An assets-based policy is not intended to shift risk and responsibility from collective pay-as-you-go funding

to pre-funded individual funding. The opportunities facilitated would be additional. Indeed, the Child Trust Fund offers an opportunity to *expand* the welfare state.'[175]

The idea of asset-based welfare is that it should encourage the poor to be more self-reliant, but the reverse could well be the case in practice. Simply *giving* people cash (even if conditions are attached) looks a very strange way to encourage saving, still less to foster an understanding of the importance of self-reliance. We also have to ask whether it is justifiable to take money in tax to give to people who by definition do not need it. Matched savings schemes only work if recipients can afford to set aside some of their own income in regular savings, but if they can afford to do that, why do they need taxpayers to support them?

Defenders of these schemes argue that they are the lower class equivalent of the tax breaks claimed by middle class people when they buy a house or put money into superannuation,[176] but there is a crucial difference between a tax break and a government payment. In the first case, the government agrees it will not take as much of your money away as it could—you therefore get to keep more of what you have earned. In the second case, the government agrees to give you money it has taken from other people—you therefore get to increase your income at someone else's expense. Economists may see these two situations as equivalent, but sociologically and ethically they are clearly opposites.

Schooling—necessary churning?

So far we have seen how tax changes, combined with savings and insurance schemes, could enable many people to reduce their reliance on government income support payments and health services and to regain control over their own lives. We could save for our retirement; we could put money aside to cover periods of unemployment or sickness; we could build up Medical Savings Accounts to pay for routine health care treatments and to pay for catastrophic health insurance. But what about the other big expenditure item in the welfare state budget: schooling? Could the mass of the population realistically be required to pick up the tab for the education of their children?

The answer is: probably not. Schooling is a very expensive investment in people who have not yet acquired any earning capacity of their own. Children cannot be expected to pay for their own schooling, nor are they mature enough to take out loans in the way that older students can. Tertiary students can decide for themselves whether to borrow against their own future earnings capacity to pay for courses they want to take, but school children cannot be entrusted with decisions like this. It is their parents who would have to pay for them, or who would have to take out loans, but even with generous tax concessions and flexible loan and savings facilities, many parents would struggle to afford full-cost school fees for several children over a period of many years.

The average cost of a full-cost place in a public school in Australia in 2006 has been calculated at $10,000.[177] A family with two children at school would therefore have to pay around $20,000 each year in school fees to get access to an average-price school. But the median gross annual income from all sources for Australian couples with dependent children in 2003-04 was only $72,635 (mean = $82,855), and for single

parent families it was just $31,911 (mean = $39,628).[178] An average couple would therefore have to devote more than a quarter of their entire gross income to school fees, and for many single parents it would be closer to two-thirds.

The problem is that schooling is a big cost that recurs every year over an extended period. It also falls at a time in the family life cycle when few people have reached their maximum earnings capacity, when they are facing many other demands on their income (notably housing loans), and when their household income is often depleted by one parent temporarily leaving the workforce or reducing their working hours. If we were really intent on keeping lifetime churning to a minimum, we could insist that parents save before they have children, borrow to cover any shortfall when their children go to school, and then repay these loans later in life after their children have gone through school. But a proposal like this is almost certainly not politically viable, and it is probably not desirable either, for it could lead poor or irresponsible parents to cut back on their children's education simply to reduce their future liabilities.

Given that the state requires that all children be educated, there seems little option other than for the state to continue to subsidize the cost in one way or another.[179] This means the crucial issue is not whether the state should subsidise schooling, but how these subsidies can be organized so they are least destructive of parental responsibility and control over their children's education.

Direct government funding of schools appears to be the most harmful strategy, for it insulates schools from consumer demand. By putting money in the hands of teachers and education managers, it empowers them at the expense of parents and pupils. Directing cash aid to parents so they can buy the schooling they want is a much better option, for it enables parents to retain decision-making powers. By ensuring that schools must compete for customers, this strategy increases the chances that they will pay attention to the kind of schooling parents want their children to have.

One way parental purchasing power can be supported is by giving parents education vouchers. This solution was favoured by Milton Friedman, and it has attracted a lot of attention ever since. Some advocates of vouchers believe parents should be able to top up their value when paying school fees while others want to outlaw top-ups to ensure that all parents enjoy the same purchasing power. But no matter what form it takes, the key problem with an education voucher scheme is that it reinforces the idea that it is the government's responsibility to pay for the services we use. Giving parents a voucher to spend is certainly preferable to the current system of giving the money directly to the education providers, but it still involves extensive churning, and as such it incurs many of the problems we identified with any churned benefits in Chapter 3.

A much better solution would be to require parents to pay school fees with their own money, but to help defray the cost by offering them education tax credits. An education tax credit worth, say, $10,000 per child would mean high income parents could reduce their annual tax bills by that amount, while those who do not pay this much tax could recoup the balance as a 'negative tax' payment. As with vouchers, various conditions or restrictions could be built into this system if required, but the key advantage of tax credits is that parents retain the responsibility for paying for schooling out of their own resources. As Jennifer Buckingham explains: "The benefits

of tax credits are non-fiscal: the psychological significance of parents spending their own money, whenever possible; and the diminution of the possibility for state intervention in non-government schools."[180]

Whether it were done by vouchers or by tax credits, the cost of this sort of financial support would obviously be high. Schooling currently accounts for about $30 billion of government spending (Table 2.1), and it is unlikely that changing the recipients from schools to parents would reduce this much, if at all, in net terms, although churning would be substantially reduced.[181]

Putting it all together: Roger Douglas's proposal for cashing in welfare state entitlements

None of the ideas and proposals outlined in this chapter is new, and many have been around for a long time. The question is whether we can draw on these ideas to put together a program of welfare state reform which can take advantage of the fact that so many people are now potentially in a position to finance their own welfare needs.

One person who has attempted this is Roger Douglas.[182] He argues that the welfare state needs a complete overhaul in order to return power and responsibility to working people and to remove perverse incentives that reward idleness. Rather than attempting this piecemeal, he believes the only way to win support for reform is to offer a complete package as an alternative to the existing system: 'The present system is what the Left offer. It's a package. After you've paid your taxes, they say, we'll pay for your children's education, health, money in retirement, and if you're sick or have an accident, we'll look after you. The centre Right doesn't have a package like that. That's why I think...the centre Right has to offer a package that is the equivalent and better in the areas of education, health, welfare and retirement.'[183]

Table 4.1: Value of Tax-free threshold/tax credits for different types of households under the Douglas reform plan[184]

Household Type	*Increased income*	*Elements*				*TFT*
		Super	*Welfare*	*Health*	*Education*	
Single	6,500	4,000	1,000	1,500	nil	32,000
Couple	12,000	8,000	1,000	3,000	nil	50,000
Couple + 2 children	21,500	8,000	1,000	4,000	8,500	76,000
Single parent 2 children	16,000	4,000	1,000	2,500	8,500	63,000

At the heart of Douglas's package is the introduction of a huge, variable tax-free earnings threshold with equivalent tax credits for those earning below the threshold and reduced tax rates for those earning above it (final column, Table 4.1). The idea is that all the money currently spent by government on health, education and income support should be translated into tax cuts (for those earning above this threshold) and tax credits (for those with incomes below it). This will then enable everyone to buy these things for themselves rather than having services delivered to them by government. Because New Zealand does not currently have a compulsory

superannuation system like Australia's, Douglas also proposes tax credits to fund personal super contributions, arguing that this will gradually replace spending on the government age pension.

Essentially, what Douglas is proposing is the cashing out of people's current welfare state entitlements. This would involve a massive cut in the size of the government's budget and a correspondingly large increase in household disposable incomes as people's current tax liabilities were slashed. Single people with no dependents would, for example, end up NZ$6,500 better off each year. They would be allowed to earn NZ$32,000 before paying any tax, and would face a top marginal rate of just 33 cents in the dollar on income over NZ$38,000 (those with incomes below NZ$32,000 would receive an equivalent tax credit). A married couple with two children would end up NZ$21,500 better off, enjoying a TFT of NZ$76,000 with a tax credit for those earning below this amount.

But having held back such large sums, households would have to spend much or all of the extra money in their pockets providing services for themselves that are currently provided by government. As Table 4.1 makes clear, the huge TFT/tax credits they would enjoy are made up of four elements, and all four would involve some new, compulsory expenditure on their part.

- The first and largest element is earmarked for *superannuation*. Every individual of working age would be required to contribute NZ$4,000 every year into a super fund of their choice (although Douglas suggests that anyone who preferred to stay in the existing state system could do so and would forego the $4,000 tax credit).[185] Douglas calculates that funds left untouched over 47 years of a working life would build to a final sum of NZ$1.8 million (or NZ$850,000 in real terms) which could be used to fund a decent retirement income.

- The second element is to replace existing *unemployment, sickness and accident benefits* with a NZ$1,000 tax credit which would have to be spent on private income insurance. Douglas proposes that income lost during any period of unemployment or sickness should be covered in the first 26 weeks by drawing down on the individual's NZ$4,000 annual super fund contribution (plus any other entitlements from their employer), and in the next 26 weeks by income insurance. Government benefits would therefore only be paid after a full year out of work. Absent parents (usually fathers) would also be expected to draw down on their annual NZ$4,000 fund contributions to pay for child support. Such a system would change the current incentives structure, for people would understand that they were financing their own jobless periods out of their retirement savings.

- The third element consists of a tax credit to enable people to pay for catastrophic *health insurance* as well as everyday health expenditures.[186] The size of this component of the TFT/tax credit would vary by family size (and perhaps also by age and risk group), so a single person would qualify for NZ$1,500 while a couple with two children would claim NZ$4,000. People would be expected to pay a deductible of 5% of their income before claiming on their health insurance, and any balance left unspent during a two year

period could be cashed out. The total cost of tax credits would equal the amount currently spent by government on providing health care.

- Finally, there would be an *education* tax credit (what Douglas calls an 'Opportunity Scholarship') worth around NZ$4,500 per dependent child (somewhat less for children below school age). Parents could spend this on any approved school of their choice, and any monies underspent would accumulate and be available for education fees later in life.

Douglas believes his package is affordable, for the only new spending is the superannuation component (the rest is simply transfers from existing government budgets back to households). There are nevertheless two features of his radical reform program that require further thought.

One is that large numbers of people would still be encouraged to look to the government to give them money. True, government would no longer be providing people with schools, health care and welfare benefits, but it would be directing a lot of cash at them in the form of various tax credits to enable them to buy these services for themselves. This is certainly a step forward from present arrangements, for having money in your pocket extends personal choice, but extensive reliance on tax credits is still likely to promote a sense of dependency on government revenues. A welfare state based on massive cash transfers is still a welfare state.

If the aim is for more people to take on genuine responsibility for themselves and their dependents without having to rely on government cash transfers, then a better way to do it might be to allow them to withhold tax payments in return for giving up claims on the welfare system. Rather than cashing in their current *entitlements* in return for tax credits, as Douglas proposes, they would withhold some or all of their current welfare state tax *contributions.* In Chapter 5, we shall see how this might be done.

A second problem with Douglas's program is that (with the exception of retirement savings) his plan forces people out of the existing state system and into the private sector where they would be compelled to save or insure—compulsory retirement savings, compulsory health insurance, compulsory unemployment insurance, and so on. This would undoubtedly generate major political tensions, for some people would almost certainly prefer to remain with existing arrangements.

We saw earlier that some element of compulsion is unavoidable if we want to guarantee that nobody falls into destitution through their own folly or recklessness. If self-reliance is not to be undermined by the free-rider problem, people must either be required to pay tax, so the government will take care of them, or they must be required to save or insure, so they can take care of themselves. Douglas is right that a system of personal savings and insurance is better than a tax-based system, for being forced to contribute to your own fund is a lot less onerous than being forced to contribute non-earmarked money to a general pool via the tax system. But it is unwise to demand that people switch from a tax-based system to one based on personal contributions. They should be allowed to judge for themselves whether it is better to pay high taxes for a government system, or to use their own money to make their own arrangements.

This means we need to develop policies that would allow people voluntarily to opt out of the government's system and into private alternatives, rather than compelling them to assume responsibility for themselves. This is not only more liberal; it would also make the transition from a welfare state to a self-reliance society more politically palatable.

Notwithstanding these concerns, Douglas's proposals demonstrate that a practical political program can be put together that goes beyond the twentieth century welfare state and resolves many of the problems associated with it. Douglas has demonstrated how people can be guaranteed the same or better security as they enjoy under the existing system while at the same time reclaiming responsibility for running their own lives. Work and savings incentives can be restored, tax-welfare churning can be minimised, and the power and responsibility that people have increasingly lost to politicians, bureaucrats and professional service providers can be returned to them. We do not have to put up with the existing system. There is an alternative.

CHAPTER FIVE: OPTING OUT OF THE WELFARE STATE

"Welfare's purpose should be to eliminate, as far as possible, the need for its own existence."

Ronald Reagan[187]

The key to reducing reliance on the government lies in reducing tax-welfare churning so people are left with more of their own money and do not have to ask government for help. Government assistance can then be limited to supporting those who cannot provide for themselves.

There are two ways tax-welfare churning might be reduced and personal autonomy and responsibility enhanced. One is to tighten means testing of government benefits and services so that only those who need help are able to get it. The other is to reduce taxes to leave more money in people's pockets so they can but what they need without government assistance. In this chapter I focus on the second of these two strategies. The first, I believe, is a dead-end.

Why more means testing is not the answer

One obvious way to reduce churning would be to tighten means testing of existing benefits and services to cut 'middle class welfare' and limit the flow of government spending to those who really need it.[188] But caution is needed, for Australia is already one of the most tightly means-tested welfare states in the world. We saw in Chapter 2 that we spend about the same per capita on government social benefits and services as the OECD average, but we target this spending much more tightly than other countries do. The result is that the rich get a smaller share of government social spending, and the poor get a bigger share, than in almost any other developed country.[189]

Most of this targeting occurs in the welfare benefits system. 'Middle class welfare' is extensive in health care, schooling and family support payments, but in the payment of income support and age pensions, Australia does a lot better than most other countries at restricting money flows mainly to lower income households.

This efficiently-targeted income support system has a downside, however, for it dramatically weakens work incentives. Rigorous means-testing of benefits rewards those who fail to achieve self-reliance (for they continue to qualify for welfare payments) while penalising those who do (because their benefits get withdrawn as soon as they start to improve themselves). This creates perverse work disincentives for people on welfare, for if they try to take more responsibility for themselves, their taxes go up and their benefits go down, leaving them little better off than before. Increased use of means-testing (either for access to income support or for access to government services more generally) would make this problem even worse than it is already.

Recognising this problem, the federal government has in recent years been relaxing its means tests on income support and family payments. It has reduced withdrawal taper rates on benefits and raised the income thresholds at which benefits start to be

withdrawn.[190] The proportion of working-age people experiencing very high EMTRs has fallen as a result, but this has only been achieved by increasing the total number of people eligible for benefits. When income thresholds are raised and tapers are weakened, the number of people eligible to claim benefits inevitably rises as the availability of government assistance gets pushed higher up the income scale. This has had the very unwelcome and unintended effect of increasing the proportion of the working-age population facing EMTRs of 50% or more.[191]

These sorts of paradoxical outcomes are unavoidable for as long as we remain committed to means testing. The uncomfortable choice is between penalizing effort by tightening testing and expanding the size of the dependent population by weakening it.

The only way to extricate ourselves from this dilemma is to disentangle the tax and welfare systems so that most people do not need to be given government help in the first place. The principal aim should not be to *restrict* access to existing welfare by more means testing, but to *transcend* it, by removing people from the need to rely on government payments or services. The key to doing this lies in reducing the amount of tax people pay (so they are left with more money to buy the things they need) and in allowing them to trade off some or all of their existing welfare entitlements against further tax reductions. This chapter explores how this might be done.

An integrated reform package

My strategy for reducing churning and promoting self-reliance involves five, core inter-related reforms.

The first is to reduce the *income tax* that people pay, particularly those on low incomes. At the moment, workers start to pay income tax as soon as they earn $6,000 per year. This is far below the amount they need to live on. Because the government is taking money away from people who cannot afford to pay it, it then has to prop them up with welfare services and income support payments to stop them falling into poverty. This is responsible for much unnecessary dependency on government hand-outs.

The second key reform is to reverse the huge expansion that has occurred in the scale and coverage of *family welfare payments* (Family Tax Benefit, Child Care Benefit and the like). It is right that families with dependent children should pay less tax than equivalent families without children, for their total subsistence needs are that much higher. But rather than reducing their tax, the government has been giving families with children ever-more generous welfare payments so that even middle and upper-middle income families in the eighth or ninth decile of the income distribution are now getting hand-outs. This is another major factor behind the high level of unnecessary dependency on government.

Thirdly, we need further reform of the *income support payments* system to encourage more people to look after themselves rather than relying on the government to help them. One in six adults of working age depends on welfare payments for 90% or more of their income.[192] The great majority of these are on one of the 'big three' welfare payments: Newstart/Youth Allowance (for unemployed people), Parenting Payment

(for jobless single parents or parents with an unemployed partner), and the Disability Support Pension. Important reforms have been introduced in all three of these payments in recent years, but we now need to go beyond simply tightening the entitlement rules and try to get people to take more responsibility for their own maintenance during periods of joblessness. Rather than claiming government payments, for example, it would be better if people facing short periods out of the labour market could access their own savings, just as retired people draw down on their own superannuation funds.

Fourthly, independence in retirement also needs bolstering by moving more people away from reliance on the government *age pension*. Australia is fortunate to have a compulsory superannuation scheme in place, but more needs to be done to encourage people to take full responsibility for their income needs in retirement through enhanced retirement savings.

Finally, we need to reform the funding and delivery of the two giant service industries of the modern welfare state—*health and education*. As with the reform of income support, encouragement of personal savings and insurance can play a key role here. Those who are willing to accept more responsibility for providing for themselves should be compensated with a reduced tax load.

People should not be taxed before they have earned a basic subsistence income

A crucial first step in reducing tax-welfare churning and restoring self-reliance should involve reform of the income tax and welfare payments systems and the way they interact with each other. The aim is to increase the amount of earnings workers are permitted to retain for themselves before they become liable to pay income tax. With more of their earnings retained in their pockets and purses, people will be able to buy more of the things they need without having to ask the government for top-ups.

The best way of reducing the tax burden so as to reduce dependency on government welfare payments is to raise the value of the tax-free threshold (TFT). The case for this is compelling.[193] In 1980, a worker did not pay any tax until he or she earned $4,041 per year (one-third of average earnings). Wages have gone up by more than 350% since then, but the tax-free earnings threshold has risen by less than 50%, to just $6,000 (one-ninth of today's full-time average earnings). The result is that every worker now pays tax on a much bigger proportion of their earnings than they used to. Had the 1980 personal threshold of $4,041 kept pace with earnings, it would now be over $14,000.

Anybody who earns more than $6,000 per year pays income tax, but $6,000 is clearly not enough to keep body and soul together. The government is therefore taking money away from people on low incomes who then have no choice but to ask for it to be returned to them in the form of welfare payments or services. It would be far better to take low income workers out of the tax system so that they can spend their own money fulfilling their own needs without having to claim government payments. The way to do this is to raise the tax-free earnings threshold above the subsistence minimum income level.

We can define a ‘subsistence income’ as the minimum amount somebody would receive if they were living wholly on welfare benefits. The benefits system distinguishes claimants who are expected to earn a living but are temporarily unemployed from those who are not expected to work and who therefore rely long-term on government payments. The first group qualifies for ‘allowances’ while the second (comprising mainly sole parents with young children, disabled people too incapacitated to work and retired people) qualifies for more generous ‘pensions.’ Basic subsistence can be equated with what people claiming allowances are given.

In June 2006, a single adult on an unemployment allowance was entitled to receive $255.60 per week, or $13,328 per annum, including rent allowance (see Table 5.2). A single person on a pension got substantially more - $300.15 per week, or $15,651 per annum—but pensions are deliberately set above bare subsistence level (they are benchmarked at 25% of male total average weekly earnings). We may therefore define a basic, subsistence income as $13,328 (although the argument that follows would work just as well if the more generous pension level were applied instead).

Table 5.1: Annual ‘subsistence’ income levels for different household types, based on welfare minimum payments[194]

Household type	Total welfare entitlement $	Implied $ subsistence cost for: 1st adult	2nd adult	1st child	2+ children
Single earner	$13,328	13,328	-	-	-
Single parent + 1 child	$21,824	13,328	-	8,496	-
Single parent + 2 children	$25,398	13,328	-	8,496	3,584
Couple	$21,796	13,328	8,468	-	-
Couple + 1 child	$27,308	13,328	8,468	5,512	-
Couple + 2 children	$30,881	13,328	8,468	5,512	3,573

If workers are to retain enough earnings to provide for their own bare subsistence, the tax-free threshold for single taxpayers clearly needs to be set at or beyond the minimum allowance level provided by the welfare system. This suggests the TFT should be worth at least $13,328.

The TFT used to be set well above welfare income support levels. In 1980, when the TFT was $4,041, the basic unemployment allowance paid to a single person with dependents was just $3,183.[195] The TFT was thus 27% higher than the welfare subsistence floor. Today, by contrast, it is 122% lower.

If we were to return to the fundamental principle that income tax only cuts in when people are earning above a subsistence income, it would mean that no individual taxpayer would need to seek welfare assistance for themselves, and that no individual welfare recipient would have an income high enough to make them liable to pay tax. The tax-welfare pincer which generates the high EMTRs would therefore be avoided by anyone earning above the subsistence income.[196] This would significantly strengthen work incentives (the Melbourne Institute estimates that raising the threshold by just $2,000 would draw another 50,000 people into the active labour

force).[197] And it need not break the government bank, for it has recently been demonstrated how the government could comfortably afford a phased increase in the TFT which would take the threshold well above the single adult rate of Newstart Allowance, and keep it there.[198]

A tax-free income of $13,000 or so is obviously only sufficient to maintain one person. Where a worker is earning a wage or salary which has to be shared with a second adult, he or she clearly needs a more generous subsistence allowance if the couple is to keep their heads above water. And if dependent children also have to be supported out of this income, the minimum subsistence level for the whole family will be higher again.

The welfare system takes family circumstances into account when determining an applicant's minimum income needs. An unemployed couple with no children, for example, is currently guaranteed a total minimum weekly income of $418 ($21,796 per annum), which is 64% more than a single claimant receives (Table 5.2). Similarly, a pensioner couple is entitled to $24,231 per year, 55% more than a single pensioner.

The tax system, however, is blind to family circumstances. It treats individuals as distinct income units and taxes them separately on their own earnings, irrespective of how many other people might depend upon that income.

There is a strong case for bringing the tax system into line with the welfare system by taking account of the number of people who have to be supported from any one individual's earnings (again, this used to be done in the past). This can be done by allowing a 'dependent' partner in a couple to transfer part of his/her zero-tax earnings allowance to the principal earner, assuming this is what they both choose to do.[199]

A couple should not be entitled to pool the whole $13,000+ of the second adult's TFT because their joint living costs are reduced by economies of scale (two people can live cheaper than one). If one person needs, say, $13,000 for subsistence (the current welfare minimum), two people living together do not need (2 x 13,000 = $26,000) to achieve the equivalent standard of living. Most 'equivalence scales' suggest they need about 1.5 times what a single person needs (which would give them a joint threshold of $19,500), but the welfare system is rather more generous, giving them nearly $21,800. This suggests that the shared zero-tax threshold for a couple who choose to pool their tax liability should be in the region of $22,000, which means the value of a partner's transferable threshold would be around $9,000.[200]

If tax-free thresholds were raised to around $13,000 for a single person and $22,000 for a couple opting for joint assessment, nobody living in a family without dependent children where there is at least one full-time income coming in should need welfare top-ups in order to reach a subsistence income (see Appendix I for a discussion of how these changes would affect welfare claimants who have part-time earnings). The tax and welfare payments systems would, therefore, no longer intersect, and self-reliance would be a lot higher than it is at the moment.

This leaves the question of how to tax households with children.

Child tax credits instead of family welfare payments

Table 2.5 showed that in 2001-02, an average family with two school-age children received government health, education and income transfers worth just over $500 per week, but almost $400 of the weekly taxes they were paying went into funding these same services. They would have been almost as well off if the government had simply left them alone.

A big chunk of this churning is represented by government family support payments such as Family Tax Benefit, Parts A and B, and child care benefits. Working parents often pay large sums in income tax, only to receive large sums back in fortnightly Family Tax Benefit (FTB) payments.[201] This generates very high EMTRs and undermines the culture and spirit of self-reliance as families become habituated to receiving fortnightly hand-outs from Centrelink.

A better way of supporting families with the cost of raising their dependent children would be to give children, as well as adults, their own tax-free income allowances representing their costs of subsistence. These allowances could then be claimed on their behalf by one or both of their parents. For example, all children might qualify for a TFT of, say, $10,000 per year. A single-earner couple with two children would then be able to earn $42,000 before starting to pay tax (they have the pooled couple's allowance of $22,000, plus two children's allowances of $10,000 each). They would not need any additional government payments because their basic subsistence needs would be covered by their own (tax-free) earnings.

However, a problem with this proposal arises when parents do not earn enough to benefit from the full increase in their total TFT. A single-earner couple earning less than $42,000, for example, would be unable to claim its full TFT entitlement and would therefore fall short of a subsistence level income unless they received some sort of top-up.

To address this problem, rather than giving children their own TFT, it might be better to allow for their subsistence costs by giving them tax credits to be claimed by their parents. Assuming a 30% marginal tax rate, a $10,000 TFT for each child works out the same as a $3,000 child tax credit (for it reduces the family's total income tax liability by $3,000 for each child). Unlike a TFT, however, a tax credit would also have value for those earning below the threshold as well as those earning above it. A two-child family on one wage of $35,000, for example, would claim the couple's tax-free threshold of $22,000, leaving them liable to income tax on their remaining $13,000. At a 30% marginal rate, this gives them a tax bill of $3,900. But they would then set against this their two child tax credits worth $3,000 each, thereby turning their tax liability into a negative income tax payment from the government of $2,100.[202]

One of the big advantages of switching from the existing system of means-tested family payments to a system of child tax credits is that tax credits will never generate EMTRs higher than the basic marginal rate of tax. Assuming a 30% basic rate, for example, our family on $35,000 will find that, as their earnings improve, their eligibility for a 'negative tax payment' declines at a rate of 30 cents in the dollar until, passing the $42,000 threshold, the start to pay tax at 30% on their additional income.

A further advantage of a system like this is that it would allow all other existing family payments to be scrapped, thereby reducing families' growing dependency on hand-outs from Canberra. This is because the system ensures that all families with children have enough money so they can get by without additional help. We would not need to worry about giving stay-at-home mums extra help with FTB Part B, or with balancing this against the Child Care Benefit available to mums who go out to work. All parents would get the same level of financial support for their children, and they could decide for themselves how best to use the money. This would effectively take us back to the situation as it applied in Australia in the 1960s, when families with children simply paid less income tax than other people did, and they decided for themselves how to use the extra post-tax income available to them.[203]

How much should the child tax credit be worth? Again, the welfare system should be our guide—although the welfare system is itself very confused about what the subsistence costs of children are, and its calculations need clarification.

Table 5.1 shows the welfare system assesses the subsistence cost of a child very differently according to whether it lives with one parent or two (the first child of a single parent is assumed to need almost $8,500 while the first child of a couple gets $3,000 less), and whether it is a first or subsequent child (the latter are deemed to cost around $3,500 for all family types). These variations seem arbitrary—why should the same child cost a single parent more than it costs a two-parent family?—and they need to be re-examined to determine their rationale.

The principle, however, is clear. The value of the child tax credit should be tied to the imputed cost of children as defined in the benefits system. For example, if the first child of a family on welfare is thought to cost its parent or parents an additional $5,500, then this should also be the value of the first child's tax credit accruing to a working family. Similarly, if each subsequent child increases the welfare payment to the family on benefits by, say, $3,500, then this should also be the value of the tax credit for each subsequent child raised by a working family.[204]

Having introduced child tax credits, all existing family payments and subsidies should be abolished. This includes, not only Family Tax Benefit Parts A and B, but also Child Care Benefit and Child Care Allowance. If parents want their pre-school child to attend child care while they both go out to work, they should pay for this using their own earnings (including the child's tax credit). If, on the other hand, they prefer to look after the child at home, then the child tax credit can help offset the loss of earnings this entails. Having provided parents with a tax reduction in recognition of the fact that children have their own necessary subsistence costs, the government can safely leave it to parents to decide how this money should best be used.[205]

The principle of welfare state opt-outs

Raising the income tax threshold and reforming the family payments system would go a long way in restoring self-reliance, but in addition we need policies that will enable or encourage people who currently use welfare state benefits and services to make their own arrangements. There are two ways this might be done. They can be pushed out of the welfare state or they can be coaxed into self-reliance.

We saw examples of ‘pushing’ in Chapter 4 when we considered both Roger Douglas’s and Charles Murray’s proposals for reform. Murray would shut down most of the government health and welfare system and compensate people with a per capita annual lump sum; Douglas would replace government benefits and services with tax credits. Neither of these proposals offers the option of staying with the state system if preferred. The welfare state is shut down and privatized, and that is that.

The problem with big bang strategies like these is that they will scare many voters. Millions of us have grown accustomed to dependency on government, and the political reaction to a wholesale privatization of the welfare state would quite likely be hysterical. Fear of such a radical change would certainly be amplified by vociferous interest groups which would do everything they could to defend a high tax, high expenditure welfare state. For reforms like this to work, people must not feel threatened, and the best way to put the electorate at its ease is to go down the voluntary route. Let those who want to ditch the state system do so, but allow those who feel the need to cling on to it remain with the system they know.

Existing government policies which support private alternatives to state welfare have evolved through a combination of pushing and coaxing. When Paul Keating reformed retirement savings, he pushed people more than he coaxed them, although the pushing was disguised by levying employers rather than employees. Workers (through their employers) are now forced to put money into personal superannuation, and these savings replace or reduce their dependence on the means-tested government age pension. Although we do dangle some carrots in the form of tax reductions on superannuation contributions, the system is essentially coercive.

In health care, by contrast, we coax people more than we coerce them. Those who buy private health insurance receive a 30% tax rebate on their premiums, and higher-rate income tax payers who do not buy private health insurance are penalized with a 1% Medicare Levy surcharge. People with private health insurance can still use a public hospital if they want to, and when they use a private hospital their treatment is subsidized by Medicare. They also continue to enjoy the benefits of Medicare’s GP cover and the Pharmaceutical Benefits Scheme (PBS). But the logic of the 30% rebate is that, in return for removing themselves from reliance on the state hospital system, patients can retain more of their private income free of tax to help them pay for their private cover.[206]

The proposals that follow involve some coercion (everyone will be required to build up their own savings to reduce their reliance on government payments during temporary periods of sickness or unemployment), but they mainly consist of coaxing. They aim to offer people the choice between staying in the welfare state system or opting out of it.

The basic idea is that people who agree to take more responsibility for themselves should be allowed to retain more of their taxable income so they can afford to buy replacement services, but that those who prefer to remain in the state system can stay as they are. People seeking to opt out could be allowed to exchange some or all of their current welfare entitlements for tax reductions, but those who prefer to remain in the state system would continue to pay their full tax liabilities.

The idea of opt-outs is not new. Prominent ‘centre-left’ Australian thinkers like Vern Hughes and Noel Pearson have suggested that people might be allowed to cash out their entitlements to Medicare and subsidised pharmaceuticals, as well as treatment in public hospitals.[207] Hughes, for example, proposes that individuals should be permitted to divert their Medicare contributions, plus their share of expenditure on public hospitals and the Pharmaceutical Benefits Scheme, to health care cooperatives of their choice. These cooperatives, modelled on the old Friendly Societies, would levy membership fees as well as receiving their members’ cashed-out contributions from the government, and in return they would provide a specified range of health care services, buying hospital beds or specialist care from other health care providers as required. Noel Pearson advocates a similar model of communal Medicare opt-outs for remote Indigenous communities living on the Cape York peninsular.

There are two major differences between these ideas and the opt-out scheme to be proposed here. One is that my scheme will not be limited to people wishing to join a health care cooperative, but would allow anybody who wants to opt out of the government system to withhold some or all of their contributions and spend the money on approved health care providers of their choice. Some might choose to join a not-for-profit health care mutual society such as those favoured by Hughes and Pearson, but others might prefer to use the money to buy private health insurance or to build up their own Medical Savings Account. Furthermore, my proposals do not stop at health, for I also suggest offering opt-outs to people who are prepared to organise their own retirement savings in return for relinquishing their entitlement to a government age pension.

The second difference is that, Hughes and Pearson would allow people to cash in the total value of their *entitlements* whereas my proposals would only allow them to withhold part or all of their *contributions*. The entitlements opt out favoured by Hughes and Pearson is not dissimilar from the reform agenda developed by Roger Douglas and discussed in Chapter 4, for it would allow people to cash in the total value of the benefits and services they currently enjoy, irrespective of how much of their own money they have paid in. A contributions opt out, by contrast, would only allow people to keep back money which they themselves currently pay in. An entitlements opt out would give people their own money (which is currently churned back to them) plus money raised from other taxpayers and redistributed to them. A contributions opt out is much more modest, for it allows you to keep your own money but not to cash in other people’s.

There are arguments for and against both entitlement and contributions opt outs. Both allow people more choice and control than the existing system does, and in this sense either would be an improvement on what we have at the moment. Entitlements opt-outs will probably appeal more to the left (for they are more inclusive as anybody can cash in their entitlements), while contributions opt-outs will probably appeal more to the right (since they are limited to people withholding their own money and therefore involve no redistribution). Their relative merits should be debated—indeed, this is precisely the debate that should now be taking place in social policy.

A majority of voters regularly tells opinion pollsters that they want to pay more tax so that government can increase its spending on services such as public hospitals and public schools.[208] A policy offering opt-outs would allow those voters who really do

want to support the state system to remain with the high tax welfare state they say they want. But there is no reason why the rest of us should be forced to accept a system we do not want. Opt outs would allow those of us who think we can organise something better for ourselves to do so by using our own money and making our own spending and savings decisions.

Time alone will tell who has made the wiser choice. If opt-outs prove to be a bad deal, people will not pursue them and the government system will survive and continue to expand. But if private solutions offer people a better deal than the government system provides, people will start to vote with their feet. The twentieth century welfare state will then gradually wind down, not as a result of political compulsion, but as the outcome of the voluntary choices made by millions of ordinary Australians.

Arguments against opt-outs

One concern about op-outs is the worry is that affluent people who can afford to buy good quality services will take their money out of the public system, leaving poorer people marooned in a declining state sector from which they cannot afford to escape. Economists refer to this as the ‘adverse selection’ problem.

Adverse selection would not be a problem, however, if affluent people were permitted to withhold only that proportion of their taxes that is currently being used to finance their own needs, and continued to pay tax to support those who cannot support themselves. This would mean people remaining in the state system would not be any worse off than they are now.[209]

We saw in chapter 2 that about half of all the money spent on the welfare state at the moment is redistributed from richer to poorer households (the other half is churned back to the people who provided the money in the first place).[210] This redistributive component of the existing system would continue under a system of opt-outs. The only welfare spending that would be reduced would be that which is currently churned back to taxpayers, not that which is redistributed. In principle, therefore, poorer people remaining in the state system should not be any worse off as a result of opt-outs.

Another concern sometimes expressed by economists is that allowing people to opt out of their contributions will increase what they call ‘deadweight losses.’ The argument here is that many Australians are already deserting the welfare state without opt-outs, so ask the government to forego revenue by giving them additional tax reductions?

More than one-third of parents pay to have their children educated in non-government schools even though they are forced to pay taxes for the schools the state provides. Similarly, about forty per cent of households pay for private health insurance to give them access to medical treatment in non-government hospitals while simultaneously paying for the public system they choose not to use. Why allow these people to withhold some of the taxes they are currently paying when they are already opting out of the public system with fewer or no such concessions?

This is, however, the wrong way of looking at the problem. The more pertinent question is why should people of modest means who do not want what the government is providing nevertheless be forced to pay for it? As I argued in chapter 3, western welfare states are undergoing a long-term process of privatization reflecting rising real incomes and a revolution in popular aspirations and expectations. With the expansion of the 'middle mass' of the population, the distribution of income and assets has been shifting from its traditional triangle-shape to something more resembling a diamond (Figure 3.1). Given the opportunity, many of the people clustered around the middle of this diamond have shown they prefer to spend their own money buying the services they want, and they have been voting with their feet. The problem, though, is that many others are being deprived of this opportunity as a result of the tax that is being taken from them which leaves them with insufficient to funds to pay again for private alternatives.

The real question we should be asking ourselves, therefore, is not how we can defend a universal welfare state by forcing people to pay for it even when they do not want it, but how we might enable more people (especially those in the lower half of the income-asset triangle) to exercise the sorts of choices that more affluent people are already enjoying?

How can the poor opt out?

The problem in extending choice to lower income households is that many of them do not seem to be paying enough income tax to enable them to trade off their welfare state contributions against tax reductions. Indeed, even in the middle of the income-asset diamond, there are people (especially those with families) who seem to be getting more out of the system than they are putting in.

Table 5.2: Dollar value of taxes paid, and welfare benefits and services received, by households at different income levels, 2001-02 ($ per year)[211]

	Equivalised household disposable income				
	Bottom quintile	**2nd quintile**	**Middle quintile**	**4th quintile**	**Top quintile**
Private income	1486	15682	40439	65709	108959
Cash benefits	12199	13354	6506	2602	578
Welfare services					
- health	(6172)	(6648)	(5688)	(4815)	(3997)
- education	(3063)	(5481)	(5721)	(4734)	(2677)
- other	(736)	(196)	(86)	(24)	(12)
- all	9970	12325	11496	9753	6686
Direct tax	132	2013	7226	13732	28751
Indirect tax	3053	4186	5812	6985	9764

Table 5.2 shows that households in the middle of the income distribution paid an average of $7,200 of income tax in 2001-02. This is a lot of money, but these households also consumed an average of $6,500 of government cash transfers, mainly

consisting of family payments claimed by those with dependent children, as well as an estimated $5,700 of health services. These figures are averages and reflect the high value of government benefits and services flowing to families with children; many middle income households consume nothing like this amount. Nevertheless, the Table suggests that the scope for opting out may be limited, even among middle income households, and lower down the distribution it is even tighter. Households in the bottom fifth of incomes, for example, paid almost no income tax in 2001-02, but they received an average of over $12,000 in benefits and over $6,000 in health spending.[212]

We saw in chapter 2 that the most prosperous quarter of Australian income tax payers contribute 64% of all income tax revenues but the least prosperous quarter pay just 3%.[213] It is easy to see how the former might be attracted to a tax-welfare trade-off, but there seems little scope for the latter to participate, for they pay so little income tax that there is little money for them to claw back. (This may help explain, incidentally, why so many people tell pollsters they are happy for taxes to rise to pay for more government spending, for in many cases it is not their money they are willing to sacrifice).

The crunch question, therefore, is how people who pay relatively small amounts of income tax can be enabled to opt out of a system when they are paying almost nothing into it? There are four things to say about this problem.

First, it is important to reiterate that low income people who pay little or no income tax and who therefore have little scope for swapping welfare entitlements for tax reductions would not be left any worse off under these proposals than they are now. They would remain in the state system and would continue to receive its benefits and services, just as they do now.

Secondly, people who pay little or no income tax still pay significant sums in indirect taxes such as the federal GST and state government duties on petrol, tobacco, alcohol, and the like. If some way could be found to enable them to reduce the indirect (as well as direct) taxes they pay, in return for reducing their use of government benefits and services, then the scope for mass opt-outs could be significantly enlarged. Appendix II outlines one way this might be done.

Thirdly, opting-out does not have to be an all-or-nothing decision. It should be possible for people to trade off welfare entitlements in one area of government provision but not in another. Even those who pay little tax should therefore still be able to find one or two services or benefits which they could afford to trade in for tax reductions if they choose to do so.

Finally, and most importantly, the long-term net tax contribution of many low income households is not as slight as the one-off statistics in Table 5.2 appear to suggest. This is because, as we saw in Chapter 2, people’s incomes fluctuate over time. While it is true that only a relatively small number of people pay substantial amounts of income tax at any one time, many more people pay a lot more income tax over the course of their whole lifetimes. This means that, over an extended period, even the ‘poor’ enjoy some capacity for opting out of the welfare state.

This is a crucial point. We saw in Chapter 2 that even the lowest lifetime earners pay enough income tax in the course of their lives to pay for half of all the welfare benefits they are given. In principle, therefore, even relatively poor households should be able to reduce their lifetime tax bills in return for opting out of some long-term welfare entitlements. They will only be able to do this, however, if some combination of loans, savings and insurance is available to help them 'smooth out' the peaks and troughs in their lifetime earnings. The opt-out proposals developed below are designed precisely to provide them with this capacity.

A 'Personal Future Fund' for everyone

The cornerstone for a new system of opt outs will be an enhanced system of personal savings. As I have suggested elsewhere, this should be kick-started by denationalizing the federal government's 'Future Fund' and redistributing the money to all Australians in the form of 20 million new personal savings accounts.[214]

The Future Fund came into existence in May 2006 as a repository for federal government budget surpluses and receipts from the sale of Telstra. Its assets are currently estimated at around $55 billion, and some predict the Fund could be worth as much as $100 billion as early as 2010.[215] The government says it needs this money to pay for under-funded, defined-benefit public service pensions which are expected to amount to $140 billion by 2020, but many economists believe the best way to help future generations meet these liabilities is to increase the size of the economy by encouraging individuals and businesses to invest. Taking tax from individuals and businesses to build up a government savings fund will depress private investment and may therefore leave future generations worse off than they would otherwise be.[216]

The main reason the government set up its Future Fund was to soak up budget surpluses and lock away privatisation proceeds at a time when the public debt had all but been repaid (any further repayment would have led to the collapse of the government bond market).[217] The Treasury was worried that cutting taxes could stoke inflation, so the government continued to levy taxes it did not need and then buried the money away in a fund that cannot be touched for another fourteen years. But even if the inflation fear was justified (which many economists doubted), this policy still begged the question: why not allow individuals rather than government to do the saving?

Assuming the value of the Future Fund reaches $60 billion by 2008, an equal share-out among all permanent residents in Australia (children as well as adults) could provide everyone with their own 'personal future fund' ('PFF') worth around $3,000. For every Australian to have their own future fund, now and into the future, an additional $750 million would have to be earmarked each year after that so newborn children could be endowed with a PFF of equivalent value to those established earlier.[218] New immigrants would also have to be required to establish a fund of their own before taking up residence in Australia.

To save on administration costs, these funds could be set up parallel to people's existing superannuation accounts and could be run by the same financial managers. Labor's Lindsay Tanner proposed in 2005 that the money could be paid into people's existing superannuation accounts,[219] but this would exclude millions of Australians

who are not currently in the workforce (children, retired people, carers, etc.) and who do not have super funds. Besides, superannuation is limited to saving for retirement, and the idea of setting up new PFFs is to enable people to establish financial autonomy in other areas of their lives. Establishing twenty million new personal funds could provide the springboard for an opt out revolution.

Is it right to give away government assets to private citizens? In this case it is ethically justifiable, for the Future Fund consists of taxes that should never have been levied (which would be returned to taxpayers), and receipts from the sale of a company 'owned' by the public before it was privatized. The policy can also be justified financially, for it should reduce demands on government spending down the track. This is because money transferred from the government's Future Fund into 20 million individual accounts would not be spent on immediate consumption, but would be used to replace present or future calls on government benefits or services. In this way, the money will strengthen self-reliance and reduce government outlays, thus proving a much more effective 'investment in the future' than it would if it remained in the hands of the government.

Using Personal Future Funds for unemployment/sickness savings

The most basic function of PFFs would be to replace government unemployment and temporary sickness allowances for the first 26 weeks of any claim period. Used in this way, PFFs would function just like the 'Temporary Earnings Replacement Accounts' recently advocated by the centre-left Hamilton Project in the USA.[220]

The initial government transfer of $3,000 into everybody's PFF would only cover about three months worth of the current single person's basic unemployment allowance. Workers would therefore over time have to add another $3,000 of savings (at constant prices) to bring their funds up to a level adequate to cover a full six months of joblessness. This could be done through an annual levy on their gross income of, say, 1%. Such contributions would have to be compulsory, but if they were offset by an equivalent reduction in income tax, workers would be no worse off in net terms than they are now.

Under this system, if somebody lost their job and registered as unemployed (or if they were temporarily off work sick), they would draw down on their personal fund to provide themselves with a basic income for up to 26 weeks in any year.[221] During this period, they could still use the job search and training services offered by the Job Network, but they would not receive government payments. Once they resumed work, they would start to replenish their PFF through the 1% income levy.

If people were still without an income after six months have elapsed, they could revert to the existing state benefits system, claiming Newstart Allowance until new employment was secured. This is the 'conservative version' of my proposal. A more 'radical version' would be to keep people out of the benefits system altogether. They would use their PFF savings to cover the first six months of unemployment, after which they could apply for a welfare income which would be paid in return for doing a job of work, until they found employment of their own.

This alternative proposal is based on an idea I put forward a few years ago to limit periods of joblessness in order to prevent people drifting into long-term unemployment.[222] I suggested that after six months of job search, training and other forms of government assistance, claimants who fail to find work should cease to be eligible for benefits but should instead become eligible to apply for a full-time 'Work for the Dole' (WfD) placement. This would provide them with a full-time job at basic benefits rates (plus work expenses), which would tide them over until they found alternative employment.

This idea can easily be linked to the proposal for PFFs to replace unemployment and sickness benefits for the first 26 weeks of any period of joblessness. The first six months of unemployment or sickness would be covered out of savings, without having to apply for government benefits, and those who failed to find work during this six month period would then be offered a Work for the Dole placement until they found employment.[223] If this more radical proposal were adopted, the existing system of unemployment benefits could be wound up altogether.

Whether the 'conservative' or 'radical' version of this plan were adopted, people would need to top up their PFF funds with contributions from earnings. On an average wage, somebody paying a 1% annual levy into a PFF already containing the initial $3,000 of government seed money would take about five years to build up savings adequate to cover a full six months period of unemployment.[224] During this period of build-up, they would remain eligible for government benefits *pro rata*, but after that, they would be expected to look after themselves during any period of interrupted earnings not exceeding six months.

PFFs would continue to grow for as long as their owners did not draw on the money. Rather than paying tax every year of their working life for what is essentially a compulsory, government-run unemployment insurance scheme, workers would now be putting the equivalent amount of money into their own savings accounts, and for young people in particular, this could be a very attractive option. Unused or surplus balances could be cashed on retirement along with superannuation, or could be diverted to other approved PFF uses such as medical savings (discussed below).

Because unemployed people would be using their own money to maintain themselves for the first six months of job search, any shame or stigma traditionally associated with receipt of unemployment benefits would be reduced. Accusations of 'dole bludging' would lose their bite, for the cost of work avoidance would fall solely on the unemployed person themselves. And because there would be a strong motivation to find work quickly, before savings were exhausted, problems of policing eligibility and deterring fraud which are commonly encountered in the existing system of unemployment benefits would be minimised. For six months, people could more-or-less be left on trust to search for work and attention could be focused on helping them find it rather than on monitoring their efforts. Knowing that their PFF is running down, jobseekers would likely be more flexible when assessing employment opportunities, and this would reduce the drift into long-term unemployment.

Using the PFF for Medicare opt-outs

For some people, PFFs would only ever function as a replacement for unemployment and sickness benefits. But there is scope for them to be much more than just 'Temporary Earnings Replacement Accounts.' For those who wanted to opt out of Medicare, for example, PFFs could also function as 'Medical Savings Accounts.'

Everyone could be offered the right to pay a portion of their earnings (up to an annual ceiling) into their PFF to cover routine GP and pharmacy expenses and to buy insurance against medical costs such as hospital treatment. In return, they would pay less tax. Taxpayers choosing to opt out would be exempted from paying the Medicare Levy, which currently takes 1½% of their salary, and because the Medicare Levy only covers one-sixth of total government health care costs, they would also qualify for further tax reductions on top of that.[225] The total value of government health services which people currently consume obviously varies according to factors like their family circumstances and their age, but an average annual tax saving in the region of $2,500 per person would probably be required to enable people to buy the equivalent services privately.

People opting out of government health care would have this $2,500 of tax savings paid directly by their employer into their PFF (just as salary sacrificed into superannuation is paid directly into their super fund under present arrangements). They would then use this money to buy health insurance and to meet routine medical expenses. Any money not used for health purposes in any one year would accumulate in their funds to be used for medical or other approved purposes later on.

As we saw in Chapter 4, one advantage of medical savings accounts is that they enable people to agree to pay higher 'deductibles' when they buy health insurance, for having their own savings means they can afford to make a contribution towards the cost of any hospital treatment they may require. This means the cost of health insurance should fall, although the withdrawal of the Medicare subsidy on hospital treatments for private patients would pull in the opposite direction.[226]

Allowing people to trade their government health care contributions against tax reductions would not only reduce tax-welfare churning and enhance self-reliance in the area of health. It would also promote greater efficiency in the use of health services. Since free treatment under Medicare was introduced in Australia, the number of medical services consumed per person has increased by 50%, but there has been nothing like a 50% improvement in health levels.[227] Just as paying your own unemployment benefits out of a personal fund would discourage work avoidance, so paying for part or all of your own medical expenses out of a personal fund would discourage non-essential treatments. An added bonus would be that it might help promote the take-up of preventative measures and healthier lifestyles.

Superannuation tax breaks in return for opting out of age pension entitlement

When it comes to retirement, most people already have their own savings accounts in the form of personal superannuation funds, and over time these should reduce people's reliance on government age pensions. However, the superannuation system is suffering from a number of weaknesses that need fixing if it is to replace mass dependency on the age pension among retirees in the years to come.

First, the 9% salary contribution is too low to provide many retirees with an adequate income, and forecasts suggest there will continue to be widespread reliance on the age pension for a long time to come.[228] Secondly, although the 9% contribution represents a deduction from wages, it is paid by employers rather than employees, and this weakens workers' sense of responsibility for and ownership of their own fund. Thirdly, there is a perverse incentive at maturation for members to spend their super lump sums (rather than converting them into an annuity) in order to qualify for the means-tested age pension.[229] Fourthly, accumulation of capital in funds is hampered by taxes which reduce both contributions and profits, thereby reducing the amount available at maturation. And fifthly, there are concerns that administration costs are too high, further reducing the rate of asset accumulation.[230]

One way these problems could be eased would be to increase the compulsory contribution to superannuation from 9 to around 15 per cent of salary, with a mandatory 6% employee contribution. Retirees might also be forced to convert their lump sums into annuities in order to maximize their income stream and reduce their call on the age pension. But these proposals are examples of what I earlier referred to as 'pushing' people out of welfare—the government would force us to save more of our own wages, and it would require us to buy an annuity with our own savings. These changes would work, but they represent an unnecessarily illiberal response to the problems in the current system.

A better alternative would be to coax people away from reliance on the government pension by removing the tax on super contributions (and perhaps on super fund earnings too) for workers who opt out of the government age pension. Abolishing superannuation taxes for everybody would be very expensive in terms of revenue foregone, especially now that the government has removed the tax on final withdrawals for retirees over 60, and it would still not do much to reduce pressure on the age pension budget (because retirees could still choose to spend their lump sums and then rely on the government to support them in old age). But if tax reductions on super were limited to people willing to give up their entitlement to a government age pension (that is, those willing to opt out), the budget balance would look a lot better.[231]

An age pension opt-out might work by allowing people to contribute up to, say, 9 per cent of salary tax-free into their super fund (on top of the existing 9% employer contribution) in return for contracting out of any future claim on the government age pension. Faced with the choice between a government pension in 30 or 40 years time, and the opportunity to save tax-free in their own retirement fund, many younger people and higher earners could be attracted to the opt-out. The result would be a significant drop in the projected level of future government spending on the ageing population.[232]

Education tax credits

Schooling is an inherently expensive item in the welfare state budget. If the cost of paying for it were transferred from government to parents, it would represent a major item in most family budgets. Only a minority of families earn so much that they could offset this with tax reductions. Over a full lifetime, it might be possible for parents to pay school fees out of tax opt-outs, but at the time the fees are actually incurred, most

clearly cannot. For this reason, the model of trading off tax cuts for opt-outs is probably not appropriate when it comes to schooling, precisely because it represents such a major cost compressed into just one point in the lifecycle.

We argued in Chapter 4 that the answer to this problem is to replace government expenditure on schools with education tax credits paid directly to parents. This is essentially what Roger Douglas argues for in his radical plan for New Zealand, and it is also what Jennifer Buckingham has proposed for Australia.[233]

We saw in chapter 4 that the average total cost of giving one Australian child a state school education has been estimated by the Productivity Commission at $10,003 in 2003-04. If this spending were diverted into education tax credits, parents with school-age children would receive a tax credit worth $10,000 every year for every child they have in full-time schooling (in practice, the value of the credit would be somewhat lower for younger children and higher for seniors, reflecting the varying costs of educating children of different ages). Where parents are paying income tax in excess of this amount, the tax credit would reduce their tax liability. Where their income tax bills are below the value of the tax credit, however, the balance would be paid as a negative income tax transfer.

Parents would be free to spend the tax money they have saved buying an education for their children at the school of their choice. If they wanted to stay with existing state schools, they could do so—they would simply pay the money to them. If, however, they preferred a non-government school option, they could 'opt out' of the state sector and go for that instead. If they found an approved school offering the schooling they wanted at a price below $10,000, they could buy it and retain the difference; if, on the other hand, they wanted to pay for a more expensive school, of if they wanted to supplement the child's schooling with additional tuition, they could add their own money to the value of their tax credit.[234]

As with the proposals for Medicare and age pension reform, so too with the education reform, nobody would be forced to leave the existing government system. If you want a government school for your children, you can still have that. But those who want something different would be free to use their money to buy into the option of their choice.

By way of illustration…

We can illustrate how the proposals developed in this chapter might work by looking at their impact on a single person in her twenties with no dependents earning $40,000 pa gross. She also gets 9% superannuation (worth an additional $3,600) paid by her employer. The example assumes constant prices throughout.

Currently she pays $6,400 in income tax. She also pays a Medicare levy of $600. Her super fund pays an additional 15% contributions tax ($540) on her superannuation contribution (so her fund increases by only $3,060 each year). In total, she is losing $7,540 each year in tax (and that takes no account of the tax her super fund pays on any earnings, nor the indirect taxes she pays on the goods and services she buys).

Under the changes proposed here, her initial income tax liability falls from $6,400 to $5,250 as a result of increasing the tax-free earnings threshold to $13,000. She receives a one-off payment of $3,000 into her new Personal Future Fund, and is required to pay 1% of gross salary ($400) into this fund each year, but her income tax liability is reduced by the same amount. If she has no sickness or unemployment claims, it will take six or seven years on her current salary for her PFF to reach the minimum savings level needed to guarantee her a basic income for up to 6 months of unemployment. After that, her fund continues to grow by $400 every year (plus whatever the money in the fund earns) and gets increasingly into surplus.

Suppose she chooses to trade in her eligibility for the government age pension and to opt out of Medicare, PBS and the state hospital system. These should be seen as irreversible decisions—she must now make arrangements to look after herself for the rest of her life rather than expecting the government to bale her out.

Because she has opted out of the age pension, her employer's 9% super contributions are now relieved of tax (saving $540). She can also choose to pay up to $3,600 pa (a further 9% of salary) in additional voluntary super contributions. If she goes for the full amount, this would reduce her income tax by another $1,120 pa. However, let's assume for the purposes of this example that she decides to make a voluntary contribution of just half of this full entitlement—an additional payment of $1,800 per year into her super fund, attracting a further tax reduction of $540 per year.

She also opts out of government health care. Assume that the annual value of her health care entitlements over her whole life is worth, say, $2,500 (it might be more or it might be less, but for the purposes of this illustration it does not matter too much). Her tax should therefore be reduced by $2,500 per year to compensate, and this money goes into her PFF savings. She might use it by buying a health insurance policy for, say, $1,500 per annum, with the remaining $1,000 remaining in the fund to cover routine health expenditure like GP consultation fees and pharmaceuticals purchases.[235]

As a result of all these changes, her total annual tax liability has fallen from $7,540 to $2,410—a saving of $5,130. $4,590 extra appears in her net pay, and the other $540 of tax savings accumulates in her super fund as a result of the abolition of the tax on the contribution paid by her employer. However, she is now responsible for her own unemployment savings, retirement fund and health care. She has to pay $400 pa into her PFF to cover unemployment and sickness, plus $1,000 pa to cover routine health expenses. She also has to buy health insurance for $1,500, and she has decided to pay a further $1,800 each year into her super fund. In total, she is paying out $4,700 on these items. Her disposable income thus works out virtually the same as it was under the old arrangements (she is just $110 worse off each year).

Her net income has hardly changed, but what has changed is her assets balance. The deductions from her salary are now going into her own funds rather than disappearing into a black hole in the Australian Tax Office, so every year from now on, she is building up her own capital. Her superannuation fund, which used to go up by just $3,060 per year (plus earnings on the capital) is now growing by $5,400 annually (plus earnings). In addition, she now has her own future fund which is worth the initial $3,000 transferred from the government's Future Fund, plus her annual

contributions of $400 for unemployment/sickness and $1,000 for health (after purchase of insurance), less any amounts withdrawn each year to cover bouts of sickness or periods of unemployment. All this will transform her economic situation later in life.

Clearly, as she gets older and her circumstances change, her tax-welfare profile will change. If she finds a partner she may choose to split her tax liabilities with him, and if she has children, she will receive tax credits of between $3,000 and $5,000 for each of them until they reach school-leaving age. This will either reduce her tax payments by this amount or will make her eligible for negative income tax transfers, depending on her income. Once the children start school, she will also receive tax credits worth an average of $10,000 per child per year which will again either reduce her tax liability or generate negative income tax transfers. She can spend this money buying her children the kind of education she wants them to have from any approved supplier. She may also choose to increase her health insurance to cover her children (which would trigger a further reduction in her tax liability), although the state system would continue to cover her children's health care by default.

Assuming she retires at age 65 after 40 years of contributions (and expressing all values at constant prices), her super fund will be worth $683,000 (assuming 5% compound interest growth after any tax on earnings has been paid). This is almost $300,000 more than she would have built up under the existing arrangements. It is enough to buy her a retirement income annuity worth over $40,000 per annum through 25 years of retirement—more than she was earning gross during her working life! Not only that, but she also now has her PFF. If through her working life she draws down on her PFF at an average of $500 per year for routine health expenses (leaving the remaining $500 in the fund), she will have built up around $85,000 in that fund by the time she gets to 65 (again assuming 5% annual growth)—much more than she needs to pay for health insurance for the rest of her life when she will no longer be earning. The surplus can be cashed in.

All of this has been achieved on an annual salary of just $40,000—well below the current average wage in this country.

Summary of proposals

The proposals outlined in this chapter can be summarized as follows:

- The tax free threshold for income tax should be raised to the welfare subsistence income. Couples should be allowed to claim a joint TFT (equivalent to the welfare minimum for couples) if they choose to do so.
- All existing family payments should be replaced by a Child Tax Credit.
- All adults should enjoy the right to relinquish some or all of their current welfare state entitlements in return for tax reductions. Those who wish to remain in the state system can do so. Nobody could cash out more than the total value of the tax contributions they would otherwise be making.
- Voluntary opt-outs would apply to the age pension and the government health care system (Medicare, the PBS and state hospitals). In each case, those opting out would be required to make alternative provision for themselves using personal savings and (in the case of health care) insurance.

- The opting-out system would apply in a different way to education where the money spent on the state schooling system would be redirected to parents in the form of tax credits. Every parent would receive an education credit worth around $10,000 per child (at 2003 prices), and would be free to buy an education for their children at a school of their choice (government or private).
- The federal government's Future Fund would be closed and the funds transferred to new Personal Future Fund accounts. There would be a 1% annual contribution from wages into PFFs, compensated by an equivalent tax reduction.
- The primary use of PFFs would be to replace government benefits during temporary periods of unemployment or sickness. For those opting out of government health care, however, PFFs would also be used to pay for routine medical expenses and health insurance. Any surplus could be withdrawn at retirement along with superannuation.
- People opting out of their age pension entitlement would be eligible for tax-free superannuation contributions. Those who do not opt out would be required to convert enough of their lump sum at retirement into an annuity generating an income above the age pension eligibility limit.

Can the government afford to lose the revenue?

Faced with a set of radical reform ideas like these, critics will doubtless claim that it is all too 'expensive' (meaning that government will lose too much revenue). It has been estimated, for example, that every $1,000 increase in the TFT costs up to $1.5 billion in lost tax revenue, so raising the TFT to reach subsistence levels for varying types of households could drain billions of dollars from the federal government's coffers.[236] Similarly, giving people tax reductions in return for welfare state opt-outs would also make a major dent in government revenues.

Against this, however, there would be big savings on government expenditure through the scrapping of FTB and child care payments, and through the reduced demand on government benefits like unemployment payment, the age pension and Medicare. However, many of these savings would only accrue to governments over a period of time. This is bound to prompt the worry: is this reform program affordable?

A key point to remember about cost is that these reforms are *intended* to cut into government revenues. The whole point of cutting churning is that tax revenues should drop substantially so that people can retain more of their own money to provide for themselves. Given that more than two-thirds of all government spending goes on the welfare state, any serious attempt to roll back the welfare state will obviously entail a major decrease in the size of the government budget. The question is whether the reduction in revenues would be matched by a reduction in spending (that is, the impact on net rather than gross revenues).

There can be no clear answer to this without much more detailed analysis than I can provide here. In principle, if the health opt-outs are costed properly, they should prove revenue-neutral over the long term, as should superannuation tax breaks (which should be counterbalanced by the reduced numbers of people claiming eligibility for the age pension). The cost of exempting 1% of people's salaries from tax to compensate them for their PFF unemployment contributions would be countered by

the savings Canberra would make on unemployment benefit payments. The main net changes to the government budget arising from these reforms would probably be those flowing from raising the Tax-Free Threshold and substituting child tax credits for family payments.

If implemented, the ideas outlined in this chapter could result in a fall in the number of long-term unemployed, a substantial opt-out from Medicare and the age pension, and a big reduction in the size of the family support payments system. But the scale of any savings from all of this is difficult to determine in advance, and some of the savings would not begin to accrue for some years.

Conclusion

Few of the ideas outlined here are really new. Many Australians are already pursuing self-funded welfare strategies and are enhancing their independence from government as a result. More than one-third of the population is covered for hospital care by private health insurance. A similar proportion pays for its children to be educated. All employees now have personal retirement accounts.

The policy challenge is how to support and extend these and similar examples of self-reliance while still ensuring that people who cannot support themselves are cared for and looked after. In the affluent world of the 21st century, it should not be necessary for everyone to receive subsidised medicines and GP services, for two-thirds of the population to be relying on public hospitals, for three-quarters of retirees to depend on full or partial government age pensions, for 90 per cent of parents to be getting government family benefits, or for one in six working-age adults to be wholly reliant on government welfare payments to give them an income.

The mass welfare state is no longer required in order to ensure the population enjoys an adequate standard of living. Increasing numbers of people are now quite capable of ensuring this for themselves. All they need is the confidence to realize they can flourish without relying on the government to look after them.

APPENDIX I: PART-TIME WORKERS ELIGIBLE FOR BENEFITS

Chapter 5 proposes raising the single person's TFT to $13,000, with an optional couple's TFT of $22,000. This would ensure that no individual or couple in a household with at least one full-time income would need welfare top-ups in order to reach a subsistence income.

The minimum wage set by the Fair Pay Commission in November 2006 was $26,690[237] which is well above these subsistence thresholds, so even full-time workers on the lowest wage would be earning enough to get by without any additional help from the government. They would experience no simultaneous tax-welfare churning and would never encounter an EMTR above their prevailing marginal tax rate.

A problem still arises, however, in respect of low income *part-time* workers who are currently eligible for income support. Under present arrangements, unemployed people claiming Newstart or Youth Allowance can undertake part-time work and earn as much as $397 per week ($20,700 per annum) yet still retain some of their benefit.[238] This means that, even though they may be earning just $6,000 short of a full-time minimum wage, part-time workers can still be classified as 'unemployed' and eligible for benefits (and because their total income far exceeds the TFT, they pay income tax on these benefits).[239] A 1999 survey estimated that a quarter of all Newstart recipients were in some form of paid work, and they were on average spending 15 hours per week doing it (although most worked fewer than 10).[240]

Single parents on the Parenting Payment pension can earn even more than 'unemployed' people claiming Newstart Allowance. They can work and still claim a proportion of their benefit while earning up to $711 per week ($37,074 per annum).[241] This is more than $10,000 above the minimum wage. The 1999 survey of income support recipients found 35% of sole parent claimants were in paid work, and they were working on average for 14 hours per week.

People on Disability Support Pension are also allowed to take up some element of paid work without forfeiting eligibility. This does not appear to be very common, however, with just 10% of DSP claimants in paid employment in 1999, working on average 12 hours per week.

What all this means is that, although our welfare system defines a subsistence income for a single person as around $13,000 (or $15,650 if they are on a pension rather than an allowance), it offers some individuals top-ups when they are earning well in excess of this amount. The reason why this happens is that the benefits system is trying to carry out two functions which are incompatible. It seeks to provide a safety net for those with no income while also supplementing those with a small income.

Benefits were originally designed to provide a minimum safety net for people with no other source of income—people who lost their job, widows who lost a breadwinner husband, sick and disabled people who could not work. But as part-time and casual employment has become more common, the sharp demarcation between employment and non-employment has become blurred and the benefits system has evolved to accommodate this change. The traditional task of *substituting* for lost wages when

people are without work has thus been expanded to *supplementing* wages when people work for a just few hours a week.

But these two functions now contradict each other. Wage substitution requires only that benefits should be paid at subsistence level so that people can get by until they find a job. Wage supplementation, on the other hand, requires that benefits should be paid even when people have a job, and this means that the value of benefits has to be varied according to how much claimants are earning (the more they earn, the less benefit they need). There are only two ways benefits can be varied to take account of private earnings:

A. *Either,* wages earned below subsistence level can be supplemented until the total income received from all sources reaches the minimum subsistence level, at which point welfare ends. This will ensure that everyone has enough money to live on, but it means that part-time workers earning below the subsistence income will lose a full dollar of benefits for every extra dollar they earn in wages until their earnings exceed the $13,000 subsistence threshold. This offers no incentive for welfare claimants to accept a few hours work at low wages, for they end up no better off than if they remained wholly unemployed.

B. *Or*, a gentler income test can be applied, which allows claimants who work for a few hours per week to keep a proportion of their additional earnings without losing the full equivalent amount in benefits. This rewards them as they work and earn more, but it requires that benefits continue to be paid long after they have passed the minimum subsistence income. Large sums of welfare thus get paid to people who do not need it.

We encountered this dilemma in Chapter 4 when discussing Friedman's negative income tax. We saw there that, if you want to ensure everyone has a basic minimum income, you have to make a choice between destroying work incentives for people earning below that level (option A above), or paying benefits to people who do not need them and are earning well above it (option B). In Australia in recent times we have gone for option B, which is why single parents can now earn $10,000 above the minimum wage and yet still receive Parenting Payment for themselves (in addition to getting FTB payments to help with the cost of raising their children). But in the past, we adopted Option A, and it might make sense for us now to revert to that.

The minimum wage at the time of writing ($26,690) is almost exactly twice the welfare subsistence minimum for a single person ($13,328). This means that, even if they work only half-time at the minimum wage, a single person should be able to earn just enough to maintain themselves (provided we do not tax them). They should not therefore need welfare top-ups (we leave aside the question of maintaining their dependent children, which is dealt with by the proposed Child Tax Credit).

It follows that any employee bringing home less than the minimum subsistence income who qualifies for benefits (because they have no other source of financial support—no employed partner, no retirement annuity, no investment income) must be working less than half a week. Such people fall into one of two groups.

The first consists of people on pensions who are not expected or required to do any paid work. Sole parents with children below the age of 8, for example, are exempted from any work or mutual obligation requirement and qualify for a full Parenting Payment pension. This is because we say as a society that they already have a full-time commitment raising their children.[242] The same is true for people below retirement age who suffer an incapacity that prevents them from working as much as 3 hours per day—they are exempted altogether from any work obligation and qualify for a full Disability Support Pension because as a society we have decided it would be inappropriate to demand any contribution from them. And of course, people past the statutory retirement age are also excused any work obligation and, in the absence of any other source of income, qualify for a full government age pension. None of these people is expected to work, but they can if they want to, and some of them do.

The second group consists of unemployed people who are capable of working to maintain themselves and who are expected and required to do all they can to find full-time paid work. They claim Newstart or Youth Allowance which are intended only to tide them over until they return to self-sufficiency.[243] These claimants are expected to try to find full-time jobs, but if only a few hours per week employment is available, they are expected to take this until something better comes along.

People on benefits who earn less than a subsistence wage and who need welfare top-ups are therefore either expected to work full-time (like the unemployed), or are not expected to work at all (like single parents with pre-school children). Either way, there seems no compelling reason why the welfare benefits system should be distorted in order to provide them with financial incentives to take part-time work. The first group does not need financial incentives because it is required to take work if it is available; the second does not need financial incentives because there is no expectation that they should work.

But would it be *fair* to start clawing back every dollar these people earn until they reach $13,000 of earnings (the point where they would exit the welfare system)? Our existing system obviously thinks not, but the ethics here are worth thinking through.

Suppose you had no income and you approached friends or family members to help you. They agree to give you $13,000 per annum. If, later, you had the chance to earn a bit of cash, you would presumably reduce the amount you requested from these friends and family members by the amount that you are now earning, for your need for support has reduced by that amount. In other words, you would consider a 100%, dollar-for-dollar reduction in the aid they give you as entirely legitimate. It would not occur to you to complain that this reduction is somehow ‘unfair’ because it is reducing your will to work.[244]

But if it is ethically right for you to reduce your claim on your friends and family when you start to earn some money of your own, why is it not also appropriate to reduce your claim in the same way when you have been receiving money from strangers (that is, taxpayers)?

There is a strong ethical, as well as pragmatic, case for capping income support payments at or around the subsistence income level, making additional payments for those with children (as outlined in Chapter 5), and reducing benefits dollar-for-dollar

below the subsistence level when claimants combine paid work with benefits. This is essentially what Australia used to do before we started to complicate the tax-welfare system to try to accommodate part-time workers on benefits. We should return to this simpler system.

By obviating any need to stretch means tested benefits up the income scale, this change would overcome the problem of tax-welfare churning and high EMTRs for anybody earning above the welfare minimum (subsistence) income. This would bring the enormous advantage that wage earners could work harder, improve themselves and increase their earnings without having to worry about being penalized by the benefits system and its tapers.

The disadvantage, of course, would fall on the minority of people on benefits who currently do a few hours work each week, for until their earnings passed $13,000 per annum, they would be no better off from working than they would be relying wholly on benefits. If we want to retain some rewards from working for this group, one way to do it would be to pay some proportion of the benefits they loose as a result of their earnings into their PFF or superannuation savings accounts. This would still offer a significant reward for the work they do without pushing their disposable incomes above the welfare ceiling/tax floor, and the build-up of savings would help boost their capacity for self-reliance later on.[245]

APPENDIX II: THE POSSIBILITY OF AN INDIRECT TAX CREDIT

In Chapter 5 we saw that people on low incomes who pay little or no income tax nevertheless still pay substantial sums in indirect taxes. This raises the question of whether some way could be found to enable them to trade off some or all of their current welfare state entitlements against the indirect tax they pay.

Table 2.3 shows that a large amount of the money that is churned between tax and welfare is a result of the indirect taxes people pay. That Table shows that the people in the bottom one-fifth of the income distribution receive their proportionate share of total welfare state expenditure (just 21% of the total), but they contribute much less than their proportionate share of the tax used to pay for it (just 3%). This comparatively low tax contribution is due mainly to the very small amount of income tax they pay (0.2% of the total). When it comes to indirect taxes, however, their contribution is much bigger—9% of the total, or half their proportionate share.

Table 5.2 adds to this information by estimating the dollar value of tax paid and benefits and services received by different income groups (this table is not directly comparable to Table 2.3 because it is derived from an economic model rather than household survey data, and is based on tax, benefits and services in 2001-01 as against 1998-99). We can see from Table 5.2 that people in the bottom 40% of equivalised household incomes at any one time take a lot more out of the welfare state than they contribute in taxes, but that what they do contribute comes overwhelmingly from the indirect taxes they pay. Those four-fifths the way down the income scale in 2001-02, for example, paid almost no income tax (just $132 per annum), but they paid over $3,000 of indirect taxes. Those in the second quintile paid twice as much in total tax ($6,200), but two-thirds of this still came from indirect tax levies.

As Peter Whiteford points out, the bottom 40% of households face a bigger burden of indirect taxes than income taxes, so if we want to make a substantial dent in the tax-welfare churn, it would help to develop a strategy that allows taxpayers to reduce their *total* tax liability—indirect as well as direct.[246] Whiteford, however, believes this cannot be done. Short of abolishing indirect taxes altogether, he thinks there is little alternative to what we do already, which is to levy indirect taxes on everyone, and then compensate low income people with welfare transfers. If this is right, it means a lot of the churning that goes on, and the widespread dependency on government that it generates, is unavoidable.

But is he right? In an age of computer-based networks, with electronic tax returns, electronic banking and electronic funds transfer at point of sale (EFTPOS), it is perfectly feasible technologically to devise ways to allow people on low incomes to reduce their indirect tax burdens in compensation for giving up specified welfare state benefits and services.[247] The same technology that enables me to debit my bank account and credit my fly-buys by swiping a couple of cards at a supermarket checkout could also enable me to set the GST and/or government duties component of my shopping bill against my tax liabilities with the ATO, or alternatively to have my personal savings account simultaneously credited by the ATO as and when I incur indirect taxes.

For example, somebody opting out of, say, $3,000 worth of welfare state entitlements would expect to reduce their overall tax liability by the equivalent amount. If they earned enough such that their income tax payments exceeded $3,000 in a given year, this could be achieved by increasing their personal tax-free earnings allowance (so they pay less tax throughout the year), or through an end-of-year tax credit or rebate paid after they have furnished the ATO with proof of their opt-outs.[248] If they earned less than this amount, their income tax liability would fall to zero and the balance owing to them could be credited to a smart card issued by the ATO which would trigger a reduction in (or refund of) any indirect tax paid on purchases made throughout the year, up to the total value on the card.[249]

In principle, therefore, it should be possible to offer most Australians a real choice between paying taxes for government benefits and services, and opting out of at least some components of the government's welfare state system in return for tax deductions. But while indirect tax credits appear feasible, the issue is less whether it can be done as whether it would be a good idea. There appear to be three major objections.

One is that everybody should pay some taxes so that everyone is making a contribution to the common good of the country (for example, the costs of defending it). With indirect tax opt-outs, some people would end up paying nothing. However, it is doubtful whether many people even register that they are paying tax when they buy food, petrol, clothing, and so on. Unlike the USA, Australia does not require retailers to differentiate between pre-tax and post-tax prices. This makes indirect taxes relatively invisible, which is why politicians like them. It could be seen as an advantage of this proposal that retailers would have to separate the purchase price and tax component of the items they sell, just as they do in the USA. It is a basic and fundamental principle of any tax that it should be visible, yet in Australia, motorists are not told at the pump how much of the final price of each litre of petrol is tax, smokers and drinkers are not told how much of the final price of their cigarettes or alcohol is made up of duties, and shoppers are not told how much of their groceries bill is made up of GST. There is a strong case for legislation requiring that prices of all goods and services should be expressed both net of taxes and gross (including taxes).

This, however, raises a second and perhaps more telling objection which is that a scheme like this might add to the already burdensome administration costs falling on businesses. Requiring retailers to separate the tax from the final price they charge, so that tax can be credited back into the customer's PFF via the tax office computer, could add a substantial burden in extra administration. It could also work to the disadvantage of small businesses which do not have computerized accounting systems. It is one thing for Coles, BP or Ben Murphy to accommodate a change like this, but it could be quite another for a small family business to do so.

The third possible criticism is that allowing consumers to opt out of welfare state entitlements by cashing in their indirect tax payments would mean allowing some people to buy much cheaper alcohol and cigarettes. This, however, is only a 'problem' if you believe the government should use its taxation powers to try to influence the way people behave. If low income people are already drinking and smoking, it is hard

to see why they should not be allowed to withhold the tax they are paying on these purchases in return for reducing their demands on government expenditure.

Endnotes

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[1] 'Fairy Tales from the Arabian Nights', www.wollamshram.ca/1001/Dixon/dixon01_13.htm, downloaded 6 September 2004.
[2] *Budget Paper No.1: Budget Strategy and Outlook 2006-07* Appendix D, Statement 6, Table 3 (Australian Government)
[3] See Andrew Norton, 'Why politicians aren't rushing to increase taxes' In Peter Saunders (ed), *Taxploitation: The case for income tax reform* (Sydney, Centre for Independent Studies, 2006)
[4] Tony Harris, 'One wild spending spree' *Australian Financial Review* 6 December 2005
[5] Peter Burn, 'How highly taxed are we?' In Saunders (ed), *Taxploitation*
[6] The welfare state has become anachronistic for many reasons. The key one is that many of us can now afford to buy what we need, but changes in family life (which have undermined the male wage-earner model on which many welfare systems were based) and the decline of low-skilled, proletarian manual labour have also helped bring existing arrangements into question. See Gøsta Esping-Andersen, 'After the Golden Age?' In Esping-Andersen (ed), *Welfare States in Transition* (London: Sage, 1996).
[7] Charles Murray, *In Our Hands: A Plan to replace the welfare state* Washington DC, AEI Press, 2006, p.2
[8] According to David Green and Lawrence Cromwell, *Mutual Aid or Welfare State* (North Sydney: Allen & Unwin, 1984), doctors would often cross-subsidise between their wealthier and poorer patients.
[9] *Mutual Aid or Welfare State*, Appendix 9.
[10] The other major source of schooling was the Catholic Church which began to offer alternatives to state schools from the 1880s, although two-thirds of all teachers in 1901 were still employed by state education departments. Public high schools were established across the various states between 1905 and 1915. See Gerald Burke and Andrew Spaull, 'Australian Schools: Participation and funding 1901-2000', in Australian Bureau of Statistics, *Year Book Australia 2002*, Cat No. 1301.0.
[11] Michael Jones, *The Australian Welfare State* (St. Leonards: Allen & Unwin, 4th edition, 1996); Patricia Harris, 'From relief to mutual obligation' *Journal of Sociology* 37 (2001), 5-26. Jones points out that with full employment, relief work was rarely needed.
[12] New South Wales introduced widows' pensions and family allowances in the 1920s. See Michael Jones, *The Australian Welfare State*. Unlike other benefits, the Commonwealth Child Endowment was not means tested but was paid as a flat rate to all parents. This has, however, subsequently been replaced by the means tested Family Tax Benefit (FTB).
[13] Peter Saunders, *Australia's Welfare Habit, and How to Kick It* (Sydney: CIS and Duffy & Snellgrove, 2004); Jennifer Buckingham, ed., *State of the Nation* (Sydney: Centre for Independent Studies, 2004).
[14] Peter G. Saunders [no relation], 'The paradox of affluence' *Dialogue* 21 (2002), 34-42; Gregory Hywood, 'Different chefs but the result's a fiscal feast', *The Sydney Morning Herald* (6 May 2004); Phil Ruthven, 'Jobs for the future', *The Bulletin* 119:44 (2002).
[15] Des Moore, *Why We Need to Reduce Health 'Welfare',* Paper to the Bristol-Myers Squibb Seminar on Health Policy, Melbourne (19 June 2001), 4.
[16] Frank Field, *Welfare Titans* (London: Civitas, 2002), 11.
[17] I have elsewhere explained why the welfare state keeps expanding. Technological changes (that have reduced demand for traditional male unskilled labour) and changes to family life (particularly the erosion of marriage and the dramatic increase in rates of single parenthood) provide part of the explanation, although other factors (improvements in health following from a higher standard of living, the increase in household incomes with the growth of female employment, and reduced demands on family budgets with lower fertility levels) should have pushed in the opposite direction. The key factor appears to be governmental weakness in the face of pressure group demands, together with vote-buying at elections. Put simply, once established, the welfare state created a political constituency which ensured its continuing development. See Peter Saunders, *Australia's Welfare Habit,* chapter 1.
[18] They are summarized in *Centrelink Information: A guide to payments and services 2005-06* Australian Government 2005

[19] Ninety percent claim it as a cash payment from Centrelink. See Brian Toohey, 'Howard's family secret', *Weekend Australian Financial Review* (12-13 February 2005). On the question of whether it is a tax reduction or a welfare payment, see Peter Saunders 'When is a welfare payment not a welfare payment? *Australian Financial Review* 13 April 2006

[20] Precise and complete estimates are difficult given that some categories of expenditure straddle state and federal governments, and that reported expenditure statistics are sometimes incompatible with and/or overlapping from different state and federal government sources. Data reported in this Table on schools, vocational education and housing are taken from Productivity Commission, *Report on Government Services 2006* (Commonwealth of Australia 2006), tables 3.1 and 4A.1and Figure 1.1. Data on health (except pharmaceuticals) are from Australian Institute of Health & Welfare *Health Expenditure Australia 2003-04* (AIHW 2005), Tables 11 and 14 (the original 2003-04 statistics have been inflated by a factor of 5.6%, which is the average annual increase in recurrent government health expenditure over the last 10 years, to derive 2004-05 estimates). Pharmaceuticals, higher education and social security & welfare figures are from the 'actual' 2004-05 expenditure recorded in the 2006 federal government *Budget Paper No.1* Statement 6, Appendix A (higher education data include $4.9 billion on higher education institutions and $0.5 billion on student assistance).

[21] 'Bring on the big budget bucks', *The Weekend Australian* (8-9 May 2004).

[22] Based on Tables 1 and 2 from Terry Ryan, 'Compendium of taxes in Australia's federal system of government' *Tax Policy Journal* 1 (2005), 34-38.

[23] Company taxation also forces down the dividends companies can pay to shareholders, and since the superannuation funds are major shareholders, this means we pay again by accumulating less in our retirement funds.

[24] 'There is an understandable tendency to regard any set of social arrangements which has prevailed for over fifty years, and so affected the lives of two generations, as a norm. But in fact, the position of the state in society over the second half of the 20th century was historically most unusual, even anomalous' (Tim Congdon, 'Towards a low tax welfare state' *Politeia* (2002), 1).

[25] Services would probably be cheaper than they are at the moment with an inefficient state monopoly supplying them. In the case in education, for example, the average cost of a state school education in 2001 ($9,176) was much greater than for a Catholic school one ($6,822) and was almost as much as in the independent sector ($9,682) where the quality of the service is generally much higher (which is why parents are willing to pay twice in order to send their children to them). See Jennifer Buckingham, ed., *State of the Nation*, Figure 4.2.

[26] Sinclair Davidson, *Who's not paying their fair share of income tax?* In Peter Saunders (ed), *Taxploitation*.

[27] Although income tax and GST are both federal taxes, revenue from the latter is diverted to the states to help pay for services provided at the state level.

[28] Neil Warren, *Tax: Facts, fiction and reform* (Sydney: Australian Tax Research Foundation, 2004), Table 2.12, based on ABS, *Government Benefits, Taxes and Household Income 1998-99,* Cat No. 6537.0 (August 2001). Figures may not add to 100% due to rounding

[29] Gianni Zappala 'Executive Summary', in Zappala (ed), *Barriers to Participation* (Sydney: The Smith Family, 2003), 11-12.

[30] The shortfall in the share achieved by the lowest quintile is explained mainly by the over-representation of small households at the lower end of the income distribution (the second quintile does better for it contains more larger households). The extensive 'middle class welfare' going to the top two quintiles is explained by the greater propensity of higher income earner households to take-up services such as post-16 education, as well as absorbing significant amounts of government health spending. In 1998-99, the top quintile of equivalised disposable incomes (i.e. income after tax and welfare payments, and allowing for household size) received $51 worth of state education and $62 worth of state health spending each week. These amounts compare with the $44 of education and $93 of health received by the lowest quintile. See Ann Harding, Rachel Lloyd, Harry Greenwell, 'The spending patterns and other characteristics of low-income households', in Zappala, Table 1.11. Des Moore calculates that the top 40% of gross income households consume over 40% of health benefits—about $10 billion worth (see *Why We Need to Reduce Health 'Welfare',* 5).

[31] Laura Tingle, 'Robbing Peter to pay Paul and his family' *Australian Financial Review* 13 January 2006. Frank Castles has argued that, 'Means tests have been drawn not at the line separating the poor from the rest, but rather at the line which obviates 'middle class welfare' ('Needs-based strategies of social protection in Australia and New Zealand', in Esping-Andersen, 107). However, as he admits, nearly three-quarters of the retired population qualify for the age pension or other age-related payments, and we know that about 90% of families with children receive some FTB payment. It may

therefore be more accurate to say that means testing separates the 'middle mass' of the population from the rich. Certainly 'middle class welfare' is now extensive in Australia.

[32] A recent paper finds that as gross earnings have grown more unequal over the last 10 years, income tax has become even more 'progressive', nullifying the widening gap in private incomes. See Neil Warren, Ann Harding, Rachel Lloyd, *ANTS and the Changing Incidence of Australian Taxes: 1994-95 to 2001-02* Paper to the 17th ATTA Conference, Victoria University of Wellington (New Zealand, 26-28 January 2005).

[33] Australian Bureau of Statistics, *Government Benefits, Taxes and Household Income 1998-99.*

[34] Based on Table 1 in Ann Harding, Neil Warren & Rachel Lloyd, *Moving beyond traditional cash measures of economic wellbeing* Discussion Paper No.61, National Centre for Social & Economic Modelling, November 2006

[35] Abstracted from Rachel Lloyd, Ann Harding and Neil Warren, *Redistribution, the Welfare State and Lifetime Transitions,* Paper to the conference on 'Transitions and Risk' (Melbourne, 24 February 2005), Table 1.

[36] Anthony de Jasay, *The State* (Oxford: Basil Blackwell, 1985).

[37] See John Garnaut and Louise Dodson, 'It's about those promises', *The Sydney Morning Herald* (5-6 February 2005); Gregory Hywood, 'Does Howard have the courage to cut tax?', *The Age* (3 February 2005).

[38] Lloyd et al, *Redistribution, the Welfare State and Lifetime Transitions*, Figure 6.

[39] At the other end of the distribution, the highest earning households on around $2,000 per week lost a lot more than they gained ($661 against $221)

[40] Yvonne Dunlop, 'Low paid employment in the Australian labour market, 1995-97' in Jeff Borland, Bob Gregory and Peter Sheehan (eds), *Work Rich, Work Poor* (Melbourne: Centre for Strategic Economic Studies, 2001), 104.

[41] ABS, *Australian Social Trends 2002: Work – Under-utilised labour, Searching for Work* www.abs.gov.au/ausstats.abs.

[42] Bruce Headey, Diana Warren and Glennys Harding, *Families, Incomes and Jobs: A Statistical Report of the HILDA Survey* (Commonwealth of Australia, 2006), p.51

[43] *Families, Incomes and Jobs: A Statistical Report of the HILDA Survey*), p.46.

[44] Ann Harding, *Lifetime Income Distribution and Redistribution*.

[45] Ann Harding 'Lifetime versus annual tax-transfer incidence: How much less progressive?', *The Economic Record* 69 (June 1993), Tables 1 and 3.

[46] Remarkably, the poorest men pay for *all* of their welfare benefits in the course of their lifetimes, for the main redistribution which takes place in the income support system is not between rich and poor households, but between men and women. This is because women earn less (so pay less tax), receive family support payments, and live longer (thereby receiving a larger chunk of age pension spending). The poorest decile of men receive 12% of their lifetime incomes in welfare payments, but pay 13% of their incomes in tax; the poorest decile of women, by contrast, receive 31% of their lifetime incomes as welfare payments while paying just 10% of their incomes in tax. On average, men pay $90,000 (1986 prices) of tax into the income support pot but take only $40,000 out. See Ann Harding, *Lifetime Income Distribution and Redistribution.*

[47] Jane Falkingham and Ann Harding, 'Poverty alleviation versus social insurance systems'. Given that these calculations are based on the 1986 tax and welfare pattern, when indirect taxation was lower than it is now, the incidence of churning will presumably have increased still further in the years since this analysis was completed.

[48] Harding's original figures have been multiplied by 2.06 to convert to 2006 values (according to the Reserve Bank, CPI in mid-1986 was 75.6, compared with 155.7 in mid-2006, an increase by a factor of 2.06 – see http://www.rba.gov.au/Statistics/Bulletin/G02hist.xls)

[49] Ann Harding, Richard Percival, Deborah Schofield and Agnes Walker, 'The lifetime distributional impact of government health outlays', *Discussion paper* No.47, (Canberra: National Centre for Social and Economic Modelling, February 2000). The paper estimates that over their lifetimes people on average pay $46,000 for government health care and receive back $62,000 (at 1986 prices).

[50] In 2006 prices, the richest lifetime income decile receives $92,700 worth of education, compared with $79,500 received by the poorest. Ann Harding, *Lifetime Income Distribution and Redistribution.* Simultaneous and lifetime churning of education spending is discussed in detail in Mark Harrison, *Education Matters* (Wellington, The Education Forum, 2004), chapter 5.

[51] *Lifetime Income Distribution and Redistribution*, 168.

[52] See, in particular, Peter Whiteford, 'The welfare expenditure debate: "Economic myths of the left and right" revisited' Paper to the Social Policy Research Centre conference, 'A Quarter Century of Social Change', University of New South Wales, July 2005.
[53] John Hills with Karen Gardiner, *The Future of Welfare* (York: Joseph Rowntree Foundation, 1997), 19, emphasis in original.
[54] M. Rojas, *Beyond the Welfare State* Timbro, Stockholm, 2001, p.35; S. Foelster, 'Asset-based social insurance in Sweden' In S. Regan and W. Paxton (eds) *Asset-based welfare: International Experiences* Institute for Public Policy Research, London, 2001, p.75
[55] Churning appears to be just as extensive in New Zealand as in Australia. Jim Cox estimates that over their lifetimes, the top 60% of Kiwi income earners contribute 85% of tax revenues, but in return claw back 40% of all government social expenditure including 68% of the education budget and 53% of the money spent on health. They also manage to get their hands on 23% of the money spent on welfare benefits, despite the non-contributory, means tested benefits system. See J. Cox, *Middle Class Welfare* New Zealand Business Round Table, Wellington, 2001.
[56] See Jane Falkingham and Ann Harding, 'Poverty alleviation versus social insurance systems', *Discussion Paper* No.12 (Canberra: National Centre for Social and Economic Modelling, April 1996). They estimate that in Britain, the bulk of lifetime welfare cash payments is self-financed from the third income decile upwards (at the third decile, people receive £134,000 in lifetime benefits but pay £84,000 in direct tax), whereas in Australia this does not happen until the sixth decile ($64,000 received and $54,000 paid in tax.
[57] Peter Whiteford estimates it at 18% of GDP against an OECD average of 21%. However, he suggests that, once Australia's compulsory superannuation scheme is added in, and different national accounting practices are allowed for, the gap between Australian levels of social spending and those elsewhere in the OECD is "much narrower than has been thought." See Whiteford, 'The welfare expenditure debate: "Economic myths of the left and right" revisited' Paper to the Social Policy Research Centre conference, 'A Quarter Century of Social Change', University of New South Wales, July 2005, p.9
[58] Whiteford, 'The welfare expenditure debate', p.16.
[59] 'The welfare expenditure debate', p.11, emphasis added. This crucial admission that below the ninth decile of incomes churning is just as prevalent here as in other countries has been overlooked by critics who have interpreted Whiteford's paper as undermining my analysis (see, for example, Nick Gruen, 'Tax churn: How bad is it? http://www.clubtroppo.com.au/2006/01/25/tax-churn-how-bad-is-it-2/). Whiteford himself also makes a number of criticisms of my analysis of churning. Some are misplaced (e.g. he says on page 17 that any analysis should include indirect as well as direct taxes, and services in kind as well as cash welfare benefits, but my analysis does include these things). Others, I think, are wrong. For example, he denies that churning is inefficient (p.18), and claims that reducing it would not improve economic incentives (p.20-1). I shall show why these claims are wrong in chapter 3. He further suggests that policies designed to reduce or eliminate churning would be strongly redistributive and would pose severe transition problems (pp.19-20). I shall address these practical issues of how churning could be reduced in chapter 4. Suffice to note here that I have always accepted that churning could not be completely eliminated for the sorts of reasons that Whiteford raises (e.g. indirect taxation means even the poorest people in receipt of government services or cash benefits will always pay something towards the cost), although Appendix II considers how even payment of indirect taxes might be traded against welfare state opt-outs.
[60] 'The welfare expenditure debate', p.16
[61] *Redistribution, the welfare state and lifetime transitions* p.22.
[62] Table 2.2 estimates that $97 billion was raised in personal income tax in 2004-05 (see also Neil Warren, *Tax: Facts, fiction and reform,* Table 8.8 for detailed breakdown). Given a reduction in spending of $90 billion or so, less than $10 billion would need to be collected if all savings went to reducing income tax. If GST were abolished, this would reduce revenue by around $35 billion, leaving $55 billion for income tax cuts. Raising the tax-free threshold from $6,000 to $20,000 would cost about $20 billion (although recent costings put it slightly lower at $17 billion – see Malcolm Turnbull and Jeromey Temple, *Taxation Reform in Australia: Some alternatives and indicative costings,* May 2006, available from http://www.malcolmturnbull.com.au/downloads/listanon.aspx?). $36 billion was collected from the 42% and 47% tax bands in 2004-05 ($7.7bn from the former and $28.3bn from the latter). If these rates were reduced to a flat 25%, the total sum raised would fall to ([7.739 * 25/42] + [28.326 * 25/47]) = $19.7bn, reducing current revenues by another $16 billion overall. The $36 billion cost so far still leaves almost $20 billion for reducing the current 30% rate. Currently, this tax band generates $39bn. Reducing the rate by a quarter would reduce this revenue by about $10 billion (Turnbull and Temple estimate each percentage point shaved off the 30% rate costs about $2 billion, so

their estimate concurs with mine). This still leaves around $10 billion which could be used to scrap the Medicare levy ($5.8bn) and the employer taxes on fringe benefits and the superannuation guarantee ($4.6bn).

[63] Theodore Dalrymple, 'The Roads to Serfdom', *City Journal* (Spring 2005). On a similar theme, see James Bartholomew, *The Welfare State We're In* (London: Methuen, 2004), 333-4; Frank Field, *Neighbours From Hell* (London: Politico's, 2003), 33, 95, 98.

[64] Peter Whiteford, for example, observes: 'The real question is the administrative efficiency of both systems acting together, not the magnitude of "churn"' (response number 5 in the thread on 'Protecting our social security system from churn and burn' Club Troppo Blog, 22 September 2006)

[65] Nick Gruen, 'Reducing churn shouldn't be the main priority for our tax system' *Crikey.com* 6 November 2006; and Gruen, 'Protecting our social security system from churn and burn' (www.clubtroppo.com.au/2006/09/22). See also: Gruen, *Tax Cuts for Growth* (CEDA Information Paper 94, May 2006), p.10; Gruen, 'Tax churn: How bad is it?' (www.clubtroppo.com.au/2006/01/25) Gruen, 'More on churning' (www.clubtroppo.com.au/2006/11/06);

[66] Gruen describes this merely as 'better optics.' See response number 8 on the thread on 'Protecting our social security system from churn and burn,' Club Troppo Blog, 22 September 2006

[67] This point has been made by other contributors to blogsite debates on churning – for example, Spog Thag's response (number 19) in the thread on 'Protecting our social security system from churn and burn' (Club Troppo 22 September 2006)

[68] Peter Whiteford, comment 21 in the thread on 'Protecting our social security system from churn and burn' (Club Troppo 22 September 2006)

[69] These six are not the only grounds for reform, but they are the key ones. In his recent analysis of the legacy of the welfare state in Britain, James Bartholomew constructs an inventory of the damage caused by social security in which he lists eleven harmful effects including the creation of large-scale joblessness, the spread of alienation, the growth of crime and incivility, discouragement of work, discouragement of savings, the erosion of self-respect, high taxation and low economic growth. See *The Welfare State We're In* (Politico's: London, 2004), 85.

[70] 'The welfare expenditure debate', p.18

[71] Australian Taxation Office Annual Reports 2002-2003 and 2003-2004, cited in Alex Robson, 'How high taxation makes us poorer' (in P. Saunders, ed., *Taxploitation*).

[72] Geoffrey de Q. Walker, 'Tax complexity and the Rule of Law' in P. Saunders, ed., *Taxploitation*.

[73] Alex Robson, 'How high taxation makes us poorer'.

[74] According to an EU press release cited by Christian Kerr ('Janet raises the Eurocrats' ire' www.crikey,com.au, May 16, 2005), Centrelink has 24,632 employees. The 2001-02 Department of Family & Community Services annual report lists 6,115 staff employed in the Department in Canberra (http://www.facs.gov.au/annualreport/2002/volume2/part3/08.html).

[75] See Jennifer Buckingham, 'Teachers and the waiting game: Why decentralization is vital for public schools' CIS *Issue Analysis* No.98, February 2007

[76] The Community and Public Sector Union, which represents public officials at both state and federal level, boasts 180,000 members, although this includes people employed outside of the welfare state sector in areas like agriculture and roads (http://cpsu-spsf.asn.au/about_us/).

[77] Centrelink 'Fraud Statistics' http://www.centrelink.gov.au/internet/internet.nsf/ea3b9a1335df87bcca2569890008040e/bfe27439324 55988ca25706c007b6ba9!OpenDocument

[78] John Garnaut, 'Law hunts dole fraud as rich cheats go free' *Sydney Morning Herald* 6 February 2006

[79] Department of Employment & Workplace Relations, *Work for the Dole: A net impact study* (Commonwealth of Australia, 2000).

[80] Luke McIlveen, 'Welfare cheats owe us $1bn'. *The Daily Telegraph* (31 August 2004).

[81] Alex Robson, 'The Costs of Taxation'.

[82] 'Although family tax benefits appear on the expenditure side of the budget, in reality they represent tax relief.' John Howard, 'Wider choice, greater security' Speech to the Menzies Research Centre, Sydney (3 May 2005). For other examples of this argument see Peter Saunders 'When is a welfare payment not a welfare payment?' *Australian Financial Review* 13 April 2006.

[83] There are three major differences between reducing tax and increasing Family Tax Benefit payments. First, unlike a tax cut, receipt of FTB is limited to families with children. Single people and couples without dependent children pay tax and get nothing back. Secondly, unlike a tax cut, FTB is means-tested, so affluent households get nothing, even if they have children, while poorer households lose money if they increase their earnings. If it really were the case (as the PM claimed in his 2005 Menzies Centre speech) that a two-child family on $35,000 paid 'no net tax' until its income reached

$41,808, it would retain every extra dollar that it earned up until it reached this higher income. What actually happens, however, is that each extra dollar it earns is reduced by a combination of 30 cents income tax and a further 20 cents taper on the FTB means test. Far from cancelling out the disincentive effect of income tax, therefore, FTB exacerbates it, for low income families face an effective marginal tax rate of at least 50% on each additional dollar earned. Thirdly, FTB is not administered as a tax cut would be, for 90% of recipients opt to receive it as a fortnightly payment (just like any other welfare payment). Even the remaining 10% still have to pay tax up front and then get reimbursed at the end of the fiscal year.

[84] Whiteford, 'The welfare expenditure debate', p.20

[85] The state does still fund schooling and has played a key role in providing housing, although more than 80% of Singaporeans now own their homes.

[86] Mukul Asher, 'Compulsory savings in Singapore: An alternative to the welfare state', *Policy Report* No.198 (National Center for Policy Analysis, September 1995); Bob Davis and Matt Moffett, 'From nations that have tried similar pensions, some lessons' *The Wall Street Journal Online* 3 February 2005

[87] This represents a crucial difference between compulsory contributions into a personal fund and payment of taxes into a general government fund. In Australia, where employers make a 9% compulsory contribution to their employees' personal superannuation funds, it is sometimes argued that this contribution is tantamount to a tax, but this is misleading, for employees retain ownership of the money in their own funds.

[88] For example: Alex Pollock, *A New Approach to Personal Social Security Accounts,* (American Enterprise Institute for Public Policy Research: Washington, April 2005). Pollock suggests the Treasury could offer to pay inflation-indexed retirement bonds directly into people's personal accounts, and workers could then choose between this and remaining in the existing system. Either way, they would continue to pay taxes which would fund the pensions of the current generation of retirees, but over time, the number of retirees depending on the state pension would fall. This looks like an elegant solution, except it does nothing to reduce future calls on the Treasury, for all that has changed is that under the new system, individuals hold pieces of paper showing their eligibility for an income flow.

[89] Simon Kelly, Ann Harding and Richard Percival, *Live Long and Prosper?* Paper to the Australian Conference of Economists Business Symposium (4 October 2002), Table 1.

[90] It is generally recognised that 9% is not enough to provide an adequate sum for retirement (e.g. the Senate Report on *Superannuation and standards of living in retirement* (Commonwealth of Australia, December 2002, paras. 1.2 to 1.5) concluded that 'current arrangements are unlikely to deliver' a replacement retirement income of 70 to 80%.

[91] *Live Long and Prosper?,*16-18; Michael McKinnon, 'Boomers 'must sell homes to retire', *The Australian* (6 June 2005).

[92] 54% get the full rate pension and another 28% get a part-rate – Commonwealth of Australia, *A More Flexible and Adaptable Retirement Income System* (Canberra: FaCS, 2004), 2.

[93] As things stand, the cost of the state age pension will still rise, even with the SG, but nowhere near as fast as if private super had not been introduced in 1992. 'Over the next 40 years, Age Pension costs are projected to rise by a manageable 1.7% of GDP' (*Australia's Demographic Challenges* Treasury Discussion Paper, 25 February 2004, Commonwealth of Australia, 11). This increase is similar to that projected for the USA, but is much less than the OECD average of a rise of more than 3 percentage points of GDP.

[94] Note that the Medicare levy funds less than 20% of Commonwealth health spending; the rest comes from general taxation. In 2003-04, the Medicare levy raised $5.5 billion, or 17% of total Commonwealth health spending – Australian Bureau of Statistics, *Yearbook Australia,* Cat No.1301.0.

[95] Commonwealth of Australia, *Intergenerational Report* (Budget Paper No.5, Part III, 2002-3). As the report notes: 'Most of the projected growth in health spending reflects the increasing cost and availability of new high technology procedures and medicines, and an increase in the use and cost of existing services. Consumers have a high demand for more effective treatments, and expect these treatments will be provided to them soon after the technology first becomes available.'

[96] *Intergenerational Report,* Table 8.

[97] Charles Murray, *In Our Hands* Chapter 4

[98] Nicholas Barr, *The Welfare State as Piggy Bank* (Oxford University Press, 2001, 91.

[99] It is worth noting that Barr's comments appear to undermine the case for a government 'Future Fund' (see Chapter 5), for this fund can only ever represent a claim on the output created by a future generation of workers.

[100] David Green and Lawrence Cromwell, *Mutual Aid or Welfare State?* (Sydney: Allen & Unwin , 1984).
[101] In England, early government moves to introduce state schools, public health insurance and other such policies were often distrusted by working class people. See Henry Pelling, *Popular Politics and Society in late Victorian Britain* (London: Macmillan, 1968), chapter 1.
[102] Belloc's 'The Servile State', quoted in Theodore Dalrymple, 'The Roads to Serfdom' *City Journal* (Spring 2005).
[103] Charles Murray, *In Pursuit of Happiness and Good Government* (New York: Simon & Schuster, 1994), 122.
[104] See Peter Saunders and Kayoko Tsumori, 'Poor Concepts: 'Social Exclusion', Poverty and the Politics of Guilt', *Policy* (Winter 2002).
[105]The link between esteem and acceptance of personal responsibility appears to be a cultural universal. In all human societies, long-term dependency on others without some form of reciprocity is associated with low social status, weak self-esteem and powerlessness (Peter Berger, *Exchange and Power in Social Life* New York: Wiley, 1964). Those who constantly rely on unreciprocated help from other people generally wind up at the bottom of social hierarchies.
[106] John Meahan, St Vincent de Paul Society Acting President, quoted in *Media Release*, 12 March 2002. There are countless other similar examples. For example: 'Most single mums want to work but without adequate child care, family friendly workplaces and some training – they can't get jobs and look after their children' (Kathleen Swinbourne, Sole Parents Union President, quoted in *Daily Telegraph*, 22 February 2005); 'Motivation is not the issue. The reality is there is only one job for every six job seekers' (Stephen Ziguras, Research Manager at the Brotherhood of St Laurence, *Media Release* (11 September 2003); 'It is inconceivable that any appreciable proportion of workers would willingly choose to remain unemployed as a way of life' (Fred Argy, *Where to From Here?* (Sydney: Allen & Unwin, 2003, 82); and so on.
[107] Noel Pearson, 'Working for a better life', *The Australian* 17 May 2005. Anthony de Jasay puts the point eloquently: 'The more a person is helped in his need, and the higher he rates the probability of the help forthcoming (until, in the limiting case of certainty, he ends up by having *entitlements*), the more his conduct will be reliant on it…the more he is helped, the lesser will become his capacity to help himself. Help over time forms a habit of reliance on, and hence the likelihood of a need for, help.' (Anthony de Jasay, *The State,* Oxford*:* Basil Blackwell, 1985, 209).
[108] Charles Murray, *In Pursuit of Happiness and Good Government*, 156. In his most recent book, Murray argues that the European welfare state model represents 'an ideal only for a particular way of looking at life. It accepts that the purpose of life is to while away the time as pleasantly as possible, and the purpose of government to enable people to do so with as little effort as possible" (*In Our Hands* p.84).
[109] *In Our Hands* p.120. I discussed this problem in my University of Sussex Inaugural Professorial lecture, later reworked and published as 'Citizenship in a liberal society' (In Bryan Turner, ed., *Citizenship and Social Theory* London: Sage, 1993)
[110] See Robert Whelan, *Helping the Poor* (London: Civitas, 2001).
[111] Frank Field, *Neighbours From Hell* (London: Politico's, 2003), p. 33 He goes on: 'The idea that welfare should be received free of conditions is a very recent development. For most of the last 400 years the receipt of welfare has been dependent on fulfilling a series of conditions. Only since the 1960s did an opposing idea gain ground…[the] damaging belief that no matter how badly a person behaves the right to welfare is inviolate' (pp. 95 and 98). See also Frank Field, *The Ethic of Respect: A Left Wing Cause* (CIS Occasional Paper No.102, February 2006).
[112] Michael Keating 'The case for increased taxation', *Academy of the Social Sciences* 2004/1, 22. Peter G. Saunders, of the University of NSW, makes a similar case in *The Ends and Means of Welfare*, p.59
[113] Peter Berger and R. Neuhaus, *To Empower People* (Washington: American Enterprise Institute, 1987).
[114] David Green, *Working Class Patients and the Medical Establishment* (Temple Smith/Gower, 1985).
[115] David Beito, *From Mutual Aid to the Welfare State* (Chapel Hill: University of North Carolina Press, 2000).
[116] David Green and Lawrence Cromwell, *Mutual Aid or Welfare State* (Sydney: George Allen & Unwin. 1984).
[117] A review of contemporary evidence from Australasia, North America, South-East Asia and Europe suggests that 'crowding out' is still happening today. State spending on health, education and superannuation tends to vary inversely with private expenditure on such items, so in countries where

taxes and welfare spending are lower, people tend to spend more of their own money buying private services, and vice versa. Jim Cox, *Middle Class Welfare* New Zealand Business Round Table, Wellington, 2001

[118] See, for example, Richard Eckersley, 'Redefining progress', *Family Matters* vol. 51 (1998), 6-12. The Australian Bureau of Statistics has also recently developed a series of indicators intended to measure 'social progress' which includes things like burglaries, imprisonment rates, divorce rates, suicide rates and drug-related deaths (ABS, *Measuring Australia's Progress* Commonwealth of Australia 2002; *Measures of Australia's Progress* op cit).

[119] Jennifer Buckingham, Lucy Sullivan and Helen Hughes, *State of the Nation* (Sydney: CIS, 2001); Jennifer Buckingham, *State of the Nation: An Agenda for Change,* (Sydney: CIS, 2004).

[120] See Peter Saunders and Nicole Billante, 'Does prison work?' *Policy,* Vol.18, no.4 (Summer 2002-2003), 3-8.

[121]. See Muriel Newman. 'A recipe for a successful welfare system' (21 May 2002) (www.act.org.nz/action/murielnewman.html).

[122] Saunders and Billante, 'Does prison work?'

[123] For a recent example, see the St Vincent de Paul Society claim that unless the government eradicates poverty by increasing welfare spending by a further 2% of GDP, 'The community will face the costs of sharpening divisions, discord, increased crime and urban deterioration' (John Wicks, *The Reality of Income Inequality in Australia,* St Vincent de Paul Society, May 2005, 11).

[124] 'The beast must be fed *continually*… whatever of its subjects' liberty and property the state manages to appropriate must be redistributed to others. If it does not do so, the redistributive offer of its competitor would beat its own and power would change hands.' Anthony de Jasay, *The State*, 206).

[125] Anthony de Jasay, *The State*, 238.

[126] Even in just the last eight years, average real disposable incomes in Australia have risen by 15%. According to the ABS, average real disposable income rose 15% between 1994-95 and 2002-03, with even those at the bottom (few of whom are in the labour market) increasing their real spending power by 12% – ABS, *Household Income and Income Distribution* Cat No: 6523.0 (December 2004). GDP grew by an average of 2% p.a. in the 1970s, rising to 3% in the 1980s and 4% in the 1990s – Gregory Hywood, 'Different chefs but the result's a fiscal feast', *The Sydney Morning Herald* (6 May 2004).

[127] Jennifer Buckingham (ed), *State of the Nation* (Sydney: CIS, 2004).

[128] The one example where government has led rather than followed has been the shift to self-funding of retirement savings following the introduction of the compulsory Superannuation Guarantee.

[129] See Peter Saunders and Colin Harris, *Privatisation and Popular Capitalism* (Buckingham: Open University Press, 1994), chapter 1.

[130] 'Anybody who derives their income from labour is part of the working class' (Peter Costello, quoted in John Garnaut, 'Costello taxes the point'. *The Sydney Morning Herald*, 17 May 2005).

[131] For a fuller analysis of the polarisation between a middle mass and a marginalised minority, see Peter Saunders, *A Nation of Home Owners* (London: Unwin Hyman, 1990), chapter 6.

[132] Peter G. Saunders, *The Ends and Means of Welfare,* 223. The argument was initially advanced by R. Goodin and J. Le Grand (*Not Only the Poor* Allen & Unwin 1987) who accept that much welfare spending appears wasteful (in that it goes to people who do not need it), but who nevertheless defend this on the grounds that it helps bind the middle classes into the system. Giving affluent people benefits that they do not need ensures that they have a continuing interest in maintaining and improving the system, which in turn benefits those who really do rely on it.

[133] Craig Emerson, *Vital Signs, Vibrant Society* UNSW Press, Sydney, 2006, pp.22-3

[134] Roger Douglas, *Reform of New Zealand public services* (Draft manuscript, 2006)

[135] M. Friedman, *Capitalism and Freedom* University of Chicago Press 1962, ch.12

[136] *Capitalism and Freedom* p.194

[137] *Capitalism and Freedom* p.192

[138] Charles Murray, *Losing Ground* ch.11

[139] Milton and Rose Friedman, *Free to Choose* London, Secker and Warburg 1980

[140] *Free to Choose*, p.156

[141] Recent calls for the introduction of an earned income tax credit reveal all the same problems as Friedman encountered: there is a reluctance to reduce the basic value of benefits, a concern to keep a cap on overall costs (so-called 'revenue neutrality'), yet a desire to flatten the taper in order to improve work incentives. See Peter Saunders and Barry Maley, 'Tax reform to make work pay' In P. Saunders (ed), *Taxploitation*

[142] In Australia, a basic guaranteed minimum income has been advocated by (among others) Peter G Saunders, although unlike more radical advocates he has also recognized that the value of the minimum

income would need to be kept low if the cost of the scheme (and hence the tax rate levied on the working population) were not to be prohibitive. See *The Ends and Means of Welfare* Port Melbourne, Cambridge University Press, 2002, p.257. For a critique, see my review of his book in *Policy* vol 18, no.3, Spring 2002. See also his essays, 'Guaranteed minimum income revisited: paradise lost or guiding light?' and 'Guaranteed minimum income schemes revisited' from *Economic Papers*, 7(3), 1988 and 8(3), 1989; and 'Conditionality and transition as issues in the basic income debate' in Sheila Shaver and P. Saunders, *Two papers on citizenship and basic income* (SPRC Discussion Paper No.55, April 1995). Further Australian discussion can also be found in Peter Dawkins, David Johnson, Rosanna Scutella, Gillian Beer and Ann Harding, "Towards a Negative Income Tax system for Australia', *The Australian Economic Review* vol.31, September 1998.

[143] Charles Murray, *In Our Hands.* Murray's influence on libertarian thinking in Australia can be seen in the enthusiasm with which writers like Jason Soon have defended the GMI idea – see, for example, the discussion thread at the Club Troppo website, 8 September 2006: http://www.clubtroppo.com.au/2006/09/08/a-deep-fissure-in-the-conservative-movement/

[144] Charles Murray, *In Our Hands* p.2. The same claim could also be made for Australia.

[145] Personal email communication dated 22 September 2006, and post on http://larvatusprodeo.net/2006/09/09/abolish-centrelink/

[146] Whiteford is not alone in suggesting that a basic income policy would require very high tax rates if current levels of support for social security beneficiaries are not to worsen. My namesake calculates that it would involve a tax rate of between 50 and 60 per cent (Peter G Saunders, 'Conditionality and transition as issues in the basic income debate' In Sheila Shaver and Peter Saunders, Two papers on citizenship and basic income' *Discussion Paper* No.55, April 1995, Social Policy Research Centre). See also: Peter Dawkins, David Johnson, Rosanna Scutella, Gillian Beer and Ann Harding, 'Towards a Negative Income Tax System for Australia' *Australian Economic Review* vol. 31, 1998;'

[147] One type of family that would definitely suffer (because Murray explicitly intends them to) is single parents. Women under the age of 21 who have a baby would get no government help at all, and older women (who would qualify along with everybody else for the $10,000) would find that, compared with present arrangements, 'the baby will be a drain on resources' (*In Our Hands* p.64). These outcomes are deliberately engineered, for Murray wants to discourage single parenthood by penalizing single parents. As he well knows, however, the problem with this is that babies will end up suffering. It's all very well telling young single mums to rely on their own mothers to help them (Murray's solution), but what happens if their mums cannot or will not help? Are we willing to watch babies starve, or to forcibly remove them into institutional care?

[148] *In Our Hands* p.73

[149] New Zealand's former Minister of Finance, Roger Douglas, makes this point clearly: "As a practical politician I know that in a civilized country like New Zealand we would not seriously let a person starve or die in the gutter because they had not saved during their working life or purchased a health policy. The problem is that if you don't compel people to save, you end up with welfare again." 'Can New Zealand fly again?' Interview with Roger Douglas by Susan Windybank, *Policy* vol.19 No.2, Winter 2003, p.26

[150] Commonwealth of Australia 2002: *Budget Overview* 14 May, Canberra, p.5

[151] D. McCarthy, Mitchell, O and J. Piggott, *Asset rich and cash poor: Retirement Provision and Housing Policy in Singapore* Pension Research Council Working Paper, Wharton School, University of Pennsylvania, 2001; Luke Buckmaster, 'Medical Savings Accounts: a possible health reform for Australia?' Parliamentary Library *Research Note* 23 March 2006, Parliament of Australia

[152] (McCarthy, Mitchell and Piggott 2001).

[153] A *South China Morning Post* survey published on 25 August 2000 found that only 44% of respondents believed that their funds were sufficient to cover their retirement needs

[154] Data on Chile collated from: Jose Pinera, 'The success of Chile's privatised social security' *Cato Policy Report* vol. 18, no.4, July/August 1995, pp.1 and 10-11; E. Huber, 'Options for social policy in Latin-America' in G. Esping-Andersen (ed), *Welfare States in Transition* Sage, London, 1996; James Payne 'How America drifted from welfare to entitlement' *The American Enterprise* March 2005, vol.16, 26-33; Bob Davis and Matt Moffett, 'From nations that have tried similar pensions, some lessons' *The Wall Street Journal Online* 3 February 2005; Larry Rohter, 'Chile's retirees find shortfall in private plan' *New York Times* 27 January 2005.

[155] Bob Davis and Matt Moffett, 'From nations that have tried similar pensions, some lessons'

[156] *In Our Hands* p.43

[157] Nicholas Barr, *The Welfare State as Piggy Bank*, pp.17 and 52-3.

[158] Of course, as Barr points out, the more modifications and requirements we introduce into the organization of private insurance systems, the closer we come to a socialized, government-run, insurance scheme. Nevertheless, the point remains that the difficulties can be overcome through sensible use of regulation, and Barr himself offers examples of private insurance initiatives in the USA which have successfully resolved many of the problems he identifies (e.g. the Stanford University employee health scheme) – see Nicholas Barr, *The Welfare State as Piggy Bank*, p.65.
[159] Interestingly, Charles Murray insists that $3,000 of his proposed $10,000 annual hand-out to all citizens should be earmarked for purchase of health insurance (i.e. insurance would be compulsory), and he also insists that insurers should be required by law to treat the entire population as a single risk pool.
[160] Marilyn Moon, Len Nichols, Susan Wall, *Medical Savings Accounts: A policy analysis* Urban Institute Washington March 1996 (www.urban.org/publications/406498.html)
[161] Although Medicare currently reduces the cost of premiums by paying for three-quarters of the cost of treatment in private hospitals – see chapter 5.
[162] Thomas Massaro and Yu-Ning Wong ('Positive experience with Medical Savings Accounts in Singapore,' *Health Affairs* Summer 1995, 267-72) draw an interesting comparison between Singapore and Hong Kong and conclude that, "Singapore has developed a very sophisticated health care system over the past decade at much less than the world market price." (p.270). Hong Kong is also a prosperous city-state with a strong Chinese heritage of personal savings but has no MSA program. From 1984-1990, it increased real health spending by 13.1% per year compared with Singapore's 11%, yet its economy grew more slowly (6.7% real annual GDP growth compared with 8.3%).
[163] : "It is far less expensive for a provider to present a bill and be paid at the time of service than it is to file a claim and wait, often for weeks or months, to be reimbursed by an insurer" Greg Scandlen, 'MSAs can be a windfall for all' *Policy Backgrounder* No.157, National Center for Policy Analysis (Washington DC), November 2001, p.9. See also: Richard Epstein, 'Medical Savings Accounts' *Australian Private Doctor* vol.17, no.1, May 2005, p.19
[164] Michael Cannon, 'Answering the critics of health accounts' *Brief Analysis* No.454, National Center for Policy Analysis (Washington DC), September 2003
[165] Cannon, 'Answering the critics of health accounts'
[166] Singaporean workers pay between 6 and 8 percent of wages into their Medisave funds, and this money is dedicated to payment of hospital fees when required (GP services, outpatient care and long-term care are excluded). When they reach age 55, they are permitted to withdraw unused balances over and above a legal minimum deposit and to use the surplus cash for other purposes. They can also pool their funds with other family members. Those who have insufficient funds to meet their hospital bills can get help from a government safety net called 'Medifund.' Everyone also enjoys catastrophic health insurance through the government's 'Medishield' scheme, and older, disabled people can get help from another government scheme, 'Eldershield.' See Luke Buckmaster, 'Medical Savings Accounts – a possible health reform option for Australia?' Parliament of Australia *Research Note* 23 March 2006, Parliamentary Library, Canberra. Also Mukul Asher, *Compulsory Savings in Singapore: An alternative to the welfare state* National Center for Policy Analysis Policy Report No.198, 1995
[167] R. Friedman and M. Sherraden, 'Asset-based policy in the United States' In S.Regan and W.Paxton (eds) *Asset-based welfare: International Experiences* Institute for Public Policy Research, London, 2001.
[168] Robert Cornwell, *Asset building and the escape from poverty* OECD, Paris, 2003. See also Friedman and Sherraden 'Asset-based policy in the United States' p.17; M. Schreiner, M. Sharraden, M. Clancy, L. Johnson, J. Curley, M. Grinstein-Weiss, M. Zhan, and S. Beverly, *Savings and Asset Accumulation in Individual Development Accounts* Center for Social Development, Washington University in St Louis, 2001 (http://gwbweb.wustl.edu/usrers/csd).
[169] Robert Cornell, *Asset building and the escape from poverty* Paris, OECD, 2003, p.24
[170] Mark Latham, 'Owning the means' Address to NSW Fabian Society, 3 July, 2002 (http://www.alp.org.au/media)
[171] The 'Saver Plus' scheme matches money saved dollar for dollar and has been found to encourage long-term saving even when the matched sums end. See Anglicare Australia, *State of the Family 2006* (Canberra, 2006, chapter 5).
[172] The Lifelong Learning Accounts initiative offered low income people up to £250 for every £50 they spent on 'training.' This resulted in large sums of public money being defrauded and the establishment of a Parliamentary Inquiry: "During the 14 months the scheme was in operation, two and a half million accounts were opened and £265 million was handed out. No one has any idea how much learning took place. The MPs who conducted the inquiry said the scheme attracted so many bogus providers that 'the

level of fraud, misuse and abuse may never be established.'" *Weekly Telegraph* (London) 8-14 May 2002

[173] HM Treasury, *Delivering Saving and Assets* (The modernisation of Britain's tax and benefit system, Number 9), November 2001, http://www.hm-treasury.gov.uk

[174] David Blunkett, *On Your Side: The new welfare state as an engine of prosperity* (speech). London, Department of Education and Employment, 2000

[175] S. Regan and W. Paxton (eds) *Asset-based welfare: International Experiences* Institute for Public Policy Research, London, 2001, section 5).

[176] For example Cornell, *Asset building and the escape from poverty*

[177] Productivity Commission   This is an increase from the $6,457 estimated for 1999 by Jennifer Buckingham, 'The truth about private schools in Australia' *Issue Analysis* No.13, August 2000, Centre for Independent Studies

[178] Australian Bureau of Statistics, *Household Income and Income Distribution 2003-04* ABS 2005, Cat No.6523.0, Table 11

[179] It is noticeable that most libertarian blueprints for reforming the welfare state stop short of recommending that government withdraw its funding of education. Murray's *In Our Hands* makes no recommendations for stopping state funding of schooling. Nor does Roger Douglas in *Unfinished Business.*

[180] Jennifer Buckingham, *Families, Freedom and Education* Centre for Independent Studies Policy Monograph, 2001, p.73. Buckingham's book contains an excellent, detailed outline of how education tax credits might work.

[181] Gross expenditure would, of course decline, but this would be offset by the fall in tax revenues consequent upon parents claiming their tax credits. There is a possibility that net spending might even rise, for parents currently educating their children privately would become eligible for the tax credit which in some cases would be worth considerably more than the Commonwealth government subsidy currently going to the place they take up in a non-government school.

[182] Roger Douglas's ideas have been developed in a number of publications including *Unfinished Business* (Auckland, Random House 1993); *Reform of New Zealand Public Services* (paper delivered to CIS, May 2003, available from PO Box 97-161, SAMC, Auckland, NZ); *Welfare reform symposium* (paper delivered at ACT Party symposium, Parliament Buildings Wellington, August 2004, available from http://www.rogerdouglas.org.nz/welfsym1.htm); 'Can New Zealand fly again?' (interview with Susan Windybank in *Policy* vol.19, No.2, Winter 2003, 21-7). What follows is based on all of these sources, with later publications superseding earlier ones where policies appear to have changed.

[183] 'Can New Zealand fly again?', p.27

[184] *Reform of New Zealand Public Services*, p.13. All figures are NZ dollars

[185] He accepts there will be a long transition period until everyone who began work before the change was introduced reached retirement age. For these people, entitlements built up in the existing system would still be honored, alongside benefits from their personal super fund.

[186] In *Unfinished Business* (chapter 6) Douglas also proposes a second compulsory health insurance, costing 2-2.5% of income each year from age 18, to cover health insurance premiums after the age of retirement.

[187] http://www.brainyquote.com/quotes/quotes/r/ronaldreag183979.html

[188] See, for example, Des Moore, *Commonwealth Spending (and Taxes) Can Be Cut—And Should Be* (ACCI, May 2005). Moore identifies around $15 billion of social security, health, education and housing spending by the Commonwealth government that could immediately be saved and returned to workers as tax cuts. Most of his proposals aim to reduce churning by restricting access to benefits by people earning enough to pay more for themselves.

[189] Peter Whiteford, *The Welfare Expenditure Debate: Economic myths of the left and right revisited*

[190] Written answer to Senate Question N. 2481 (Senator Minchin).

[191] In 1996-97, 4.8% faced an EMTR of 50%+; in 2006-07 this has increased to 7.1%. See Ann Harding and Quoc Ngu Vu, *Income inequality and tax=transfer policy: Trends and questions.* Paper to the 'Making the Boom Pay' conference, University of Melbourne, November 2006. See also Harding, Vu and Richard Percival, *Interactions between wages and the tax-transfer system*' Report for the Australian Fair Pay Commission, NATSEM, 2006.

[192] Peter Saunders, *Australia's Welfare Habit*

[193] Peter Saunders and Barry Maley, 'Tax reform to make work pay' In P. Saunders (ed), *Taxploitation*

[194] Based on Melbourne Institute, *Poverty Lines Australia* June 2006, Table 4. Calculations are based on allowances, which are lower than pensions, and include rent assistance.

[195] Single beneficiaries received $61.05 pw. Married beneficiaries got $101.70. See: Research and Statistics Branch, 'Unemployment benefit recipients in Australia 1970-1980: An analysis' Department of Social Security, *Research Paper* No.1, November 1981
[196] Although people who are earning below $13,000 and who are mixing receipt of benefits with part-time employment could face very high EMTRs. This is discussed further in Appendix I.
[197] Peter Dawkins, *Welfare to work: Labour supply responses to work incentives* Paper to Melbourne Institute Conference 'Sustaining Opportunity and Prosperity' University of Melbourne, March 2005
[198] Peter McDonald and Rebecca Kippen, 'Reform of income tax in Australia' *Australian Review of Public Affairs* vol.7, 2006, 19-39
[199] See Terry Dwyer, 'The taxation of shared family incomes' In P. Saunders (ed), *Taxploitation.* Under Dwyer's proposals, it would be for each family to choose how it wants to be assessed. Many working couples would probably prefer to continue filing separate tax returns so that each can retain their own tax-free threshold. They would be free to do so. Couples where there is only one earner, however (and especially those who also have dependent children) might prefer to transfer part of the threshold of the non-working partner to the working partner.
[200] In recent years, the federal government has tried to counter some of the inequity in the tax treatment of individuals and couples by giving certain categories of families a welfare top-up. Family Tax Benefit, Part B, for example, is paid to families where there is only one earner to try to compensate them for the disadvantages they suffer through the tax system. The result, however, is a tangle of money transfers in which people get tax taken from them only to have some or all of the cash returned in the form of welfare payments. This is not only costly, it is also wrong in principle. We should not be taxing families until they have secured their own subsistence, and a family's subsistence level will be higher than it is for single people or couples without dependent children.
[201] Although FTB can be taken as a credit against tax at the end of the tax year, 90% of claimants take it as a fortnightly government payment
[202] Ideally, child tax credits should be built into the fortnightly wage, rather than accumulating through the year and being claimed back from the ATO as a lump sum.The same applies to the education tax credits to be discussed later in this chapter. A long overdue reform of income tax would be to adopt something like the UK's personal tax codes system where employers are given each employee's tax-free allowance and tax credit entitlement and they deduct (or supplement) the wage packet accordingly. This obviates the need for any end-of-year adjustment for PAYG taxpayers with no more than one source of income.
[203] This idea has quite a long pedigree at the Centre for Independent Studies. It is essentially what was proposed by Lucy Sullivan in her 2001 monograph, *Taxing the Family* (CIS), and by Barry Maley in *Family and Marriage in Australia* (CIS 2001).
[204] Some consideration might also be given to varying the value of the credit according to the age of the child.
[205] It would be up to parents to decide which of them claims the children's tax credits, although those who are employed will obviously claim them if they have a non-employed partner. Some critics will object that this could shift power in some families from the adult carer (usually the mother) to the principal wage earner (usually the father), for while payments like Family Tax Benefit can be claimed by either parent, a tax reduction will benefit the one who is earning. However, it is arguably no business of government to redistribute money within private families; this is a matter for couples themselves to resolve.
[206] The private health insurance rebate is usually paid to the insurer so the policy holder pays a reduced premium.
[207] Vern Hughes, 'A cure for health care' *Policy* Vol.20, no.1, Autumn 2004, 22-27; Noel Pearson, *Welfare Reform and Economic Development for Indigenous Communities*, CIS lecture, Sydney, 25 October 2005
[208] Andrew Norton 'Why politicians aren't rushing to increase taxes' In P.Saunders (ed), *Taxploitation.* In May 2003, 57% of voters said they wanted to pay more tax for government health and education spending.
[209] Welfare economists generally believe that policy should strive for a condition of 'Pareto optimality,' where nobody can be made better off without someone else being made worse off. If a change is possible which benefits one person and leaves others undiminished, then the change should be made. This is the case with these opting out proposals.
[210] 'The $85 billion tax-welfare churn'

[211] Ann Harding, Neil Warren and Rachel Lloyd, 'Moving beyond traditional cash measures of economic wellbeing: Including indirect benefits and indirect taxes' *Discussion paper* No.61, NATSEM, Canberra, November 2006
[212] 'Moving beyond traditional cash measures of economic wellbeing'
[213] Sinclair Davidson, 'Who's not paying their fair share of income tax?' Table 4.1. In P. Saunders (ed) *Taxploitation*
[214] Peter Saunders, *Twenty Million Future Funds.*
[215] Parliamentary Library, *The Future Fund* (Research Note No.43, 4 April 2005); Glenn Dyer, 'Balancing the future fund' (www.crikey.com, 10 May 2005); David Uren, 'Future fund to arrive earlier' *The Australian,* 26 October 2005; Fleur Anderson, 'Extra $2bn to seed Future Fund' *Australian Financial Review,* 7 December 2005; David Uren, 'Future fund rising to $55bn' *The Australian* 28 September 2006; 'Future fund will grow to $50b with T3' *Sydney Morning Herald* 14 November 2006.
[216] See: Australian Chamber of Commerce and Industry, *The Future Fund is Not the Best Use of Budget Surpluses* (Canberra: ACCI, 2005); Stephen Kirchner, 'Future Fund or future eater?' *Policy* Vol.22, No.3, Spring 2006, 28-35; Alan Wood, 'Income tax reform beats parking our money in Costello's future fund' *The Australian* 9 December 2006
[217]John Stone, 'Unjust, unimaginative gall of withholding cuts' *The Australian,* 2 May 2005; Alan Mitchell, 'Future Fund shouldn't be shackled' *Australian Financial Review,* 18-19 June 2005.
[218] This would ensure generational equity. Children's funds would be invested in trust until they reached school leaving age. According to the ABS (Cat.No 3301.0), 251,000 births were registered in Australia in 2002. Assuming that quarter of a million children are born each year, an indexed endowment of $3,000 to fund each of their PFFs would involve a cost to government of around $750 million annually in today's prices. Invested in trust at, say, 5% real compound rate of return, a new-born child's PFF of $3,000 would be worth $6,237 in real terms by the time they reached 15, even with no additional deposits in the intervening years.
[219] 'Excess slush a perfect plug for super hole' *The Australian* 4 May 2005
[220] 'Doling up the dole' *The Economist* September 23 2006, p.80. On unemployment savings accounts, see: Martin Feldstein and Daniel Altman, *Unemployment Insurance Savings Accounts* (Cambridge Mass: National Bureau of Economic Research, December 1998); Lawrence Brunner and Stephen Colarelli, 'Individual unemployment accounts' *The Independent Review* 8 (2004), 569-585
[221] If they had an unemployed partner, he or she could also draw down on his or her PFF if required. The costs of children would be covered by the new Child Tax Credit replacing existing family payments.
[222] See P. Saunders and K. Tsumori, 'How to reduce long term unemployment' CIS *Issue Analysis* No.40, September 2003; P. Saunders, *Australia's Welfare Habit.* Most people who lose a job find another within eight weeks, but those who remain on the dole for six months or more rapidly decrease their chances of finding new employment (see ABS, *Australian Social Trends 2002: Work, underutilised labour, searching for work*). Currently, mutual obligation activities kick in after six months, but these do not take claimants off benefits, and after another 6 months the cycle simply repeats itself. Even after 12 months of unemployment, the average Australian job seeker is still unwilling to accept a job paying less than 92.5% of what they were previously earning, and two-thirds of unemployment benefit claimants are unwilling to move to a different location within their own state in order to take work. As the spell of unemployment lengthens, so people lose their skills and the habits of work, and they gradually become disillusioned about ever finding work. Longitudinal panel research indicates that, once people get into work, even at a low wage or on reduced hours, it gives them a toehold from which they can build to better things. See, for example, the comments of HILDA survey director Mark Wooden, reported in David Uren, 'Low wage rise "no help"' *The Australian* 16 November 2006
[223] If they became unemployed while their PFF balance was below the required six-month subsistence level, the shortfall could be made up with government loans (paid at equivalent benefit rates) which would then be repaid through the 1% levy once they found another job. Those who remained unemployed for more than six months and who joined a full-time WfD placement would only earn a subsistence wage, but this could be topped up by additional government payments into their PFF, which would ensure they had a positive balance in their fund when eventually they rejoined the labour force.
[224] Assuming real compound interest of 5% pa, babies given $3,000 at birth would achieve $6,000 worth of savings by the time they entered the job market, so this transitional period where people build up their funds to the required level would gradually phase out.

[225] The Australian Tax Office estimates revenue from the Medicare levy in 2004-05 at $6.1 billion, or 17.2% of total government health expenditure that year. See Australian Bureau of Statistics, *Year Book Australia 2006*, chapter 9. In 2003-04 the average per capita value of publicly-funded health services consumed using services listed on the Medicare Benefits Schedule was $496 (this rose to around $1,000 per head for those aged over 75)—see Health Insurance Commission, *Annual Report 2003-04* Table 14. In addition, the PBS (which subsidises drugs and helps families with prescription costs) was worth around $230 per head, and Australian Health Care Agreements (covering the cost of public hospital care) come to another $364 per head—see Dept of Health and Ageing, *Annual report 2002-2003, Outcome Summary* Commonwealth Government.
[226] Medicare currently pays 75% of the scheduled fee for patients undergoing treatment in private hospitals, but people opting out would lose this subsidy. Their premiums would therefore be higher, but higher deductibles would moderate this increase (the MBF Health Fund website suggests a $1,000 excess should reduce the cost of a comprehensive health policy by about 25%). On the use of medical savings accounts to reduce the cost of health insurance premiums, see: Richard Epstein, 'Medical Savings Accounts' *Australian Private Doctor* 17 (May 2005), 17-20; John Goodman, 'MSAs for everyone' National Center for Policy Analysis *Brief Analysis* No. 318 (March 2000), No. 319 (March 2000) and No. 356 (April 2001). .
[227] Craig Emerson, *Vital Signs, Vital Society* p.79.
[228] Simon Kelly, Ann Harding and Richard Percival, *Live Long and Prosper? Projecting the likely superannuation of the Baby Boomers in 2020,* Paper to the 2002 Australian Conference of Economists, 4 October. 54% of people over retirement age currently receive a full age pension, with another 28% on part-pension and 18% receiving no pension. By 2050 it is expected that 75% of retirees will still qualify for the age pension, but with two-thirds of them receiving a reduced rate. See *A More Flexible and Adaptable Retirement Income System* (Commonwealth Government, Canberra, 2004); Hazel Lim-Applegate, Peter McLean, Phil Lindenmayer and Ben Wallace, *New Age Pensioners: Trends in wealth* (Paper to the SPRC Conference, Sydney, 20-22 July 2005).
[229] Neil Warren writes of the 'double dipping' phenomenon where individuals get tax concessions on their super contributions, spend the lump sum at retirement, and then claim the means-tested age pension. *Tax: Facts, Fiction and Reform* (Sydney: Australian Tax Research Foundation, 2004), 174-5.
[230] It is estimated that around $1 billion per annum drains out of personal superannuation funds in management and administration charges—Glenn Dyer says 'Super has become one long gravy train' ('Balancing the future fund', www.crikey.com.au 10 May 2005). Some critics claim private superannuation incurs higher administration costs than government-run schemes. See, for example, Norma Cohen, 'A Bloody Mess' (*American Prospect Online,* 11 January 2005); Nicholas Barr, *The Welfare State as Piggy Bank* (Oxford University Press, 2001), 117.
[231] Because they have relinquished any claim on the age pension, they could be left to dispose of their super fund on retirement entirely as they see fit. It would, however, be reasonable to require those who did not opt out of the government age pension to convert enough of their super lump sum into an annuity to generate a retirement income comparable to a full age pension, for this would limit eligibility for the means-tested pension to those who really need it.
[232] The main objection to this idea is likely to come from those who seek a radical simplification of the income tax system. John Humphreys ('Rebuilding Australia's tax and welfare systems', in P. Saunders, ed., *Taxploitation*), for example, argues that even the existing tax concessions on super should be scrapped in order to broaden the tax base and move to a flatter tax rate. There is certainly a strong case for reducing the number of allowances and rebates in our tax system in order to simplify the system and get the rates down. However, there is also a strong case for getting people out of the welfare state by allowing them to keep more of their own money and to use it to replace their reliance on state provisions. In this clash between two desirable principles, I believe the latter outweighs the former.
[233] See Chapter 4 on Douglas; Jennifer Buckingham, *Families, Freedom and Education*
[234] See *Families, Freedom and Education* for more elaboration.
[235] Standard hospital cover for a 25 year old insuring with MBF, excluding the 30% government rebate, but with a $1,000 excess, is currently quoted at $490. With a bigger excess, this would be lower – say, $350. Opting out of Medicare would mean paying the full service fee, so premiums would be higher than they are now, but even if they rose fourfold (reflecting the loss of the 75% Medicare subsidy), the final premium should not exceed about $1,400.
[236] Malcolm Turnbull and Jeromey Temple, *Taxation Reform in Australia: Some alternatives and indicative costings,* Paper presented at Wentworth Liberal Party branch meeting, Sydney, 1 September 2005,
[237] http://www.abc.net.au/news/newsitems/200610/s1773959.htm

[238] They are allowed to earn $31 pw without any loss of benefit, with a 50% taper on earnings between $31 and $125 and a 60% taper above that, until eligibility expires at $794.84. Details from *Newstart Payment Rates 20 September – 31 December 2006*

[239] Because unemployment benefits count as taxable income, claimants at the upper end of this income band end up paying more income tax than they receive in benefits – a classic example of tax-welfare churning. An anonymous contributor to a blogsite discussion of churning points out that the last $65 per week of Newstart Allowance is worth less than the income tax payable on an income eligible for this level of support. See http://www.clubtroppo.com.au/2006/09/22/protecting-our-social-security-system-from-churn-and-burn/, response 19

[240] Peter G Saunders, Judith Brown, Toney Eardley, *Patterns of Economic and Social participation among FaCS Customers* Dept of Family & Community Services, Policy Research paper No.19, Commonwealth of Australia 2003, Tables 4, 11, 13

[241] Since 2006, single parents whose youngest child is over the age of 8 are required to seek part-time work while those with younger children can combine employment and parenting payment if they choose to do so. Details from Centrelink, *Parenting Payment Rates 20 September – 31 December 2006*

[242] Although arguably this is really only the case while their children are below school age, for at six and seven the task is being shared with the school. Claimants whose children are older than 8 are now expected to work part-time and will therefore clear the subsistence threshold.

[243] We also now expect single parents with older children to work half-time, but as we have seen, half-time work, even on minimum wages, should generate sufficient wages to get them above the minimum subsistence income, so they should not need to remain in the benefits system at all unless they become 'unemployed'

[244] I am indebted to the anonymous blogger, Spog Thag, for making this point: "If there was no welfare system, and people were forced to get insufficient incomes topped up from brothers or sisters, etc, what would the prevailing view be about the appropriate EMTR settings to encourage workforce participation? For example, if a person needed $300 a week to live on, but only had a part-time job paying $200, they'd need to get $100 a week from their family. If that person then had a pay rise to $250 a week, their top-up requirement would now be $50. I suspect that in a system where the person paying the welfare was clearly identifiable (e.g. they were your brother), there would be little qualms about saying I now only need $50 to top me up to the necessary minimum income. In other words, in that context a 100% withdrawal of income support would be acceptable" (http://www.clubtroppo.com.au/2006/01/25/tax-churn-how-bad-is-it-2/ post 13). He goes on to suggest that, where donors are unknown to recipients, people have become conditioned to expect an incentive to give up welfare. But the same ethical precept that applies to seeking aid from family and friends should also apply to seeking help from neighbours and anonymous taxpayers. If you can find work and reduce your claim on other people, then you should do so, irrespective of whether it leaves you any better off financially.

[245] If benefits paid into savings were reduced as earnings rose, this would still create work disincentives until earnings passed the $13,000 subsistence threshold (at which point people exit the welfare system altogether). But the disincentives would not be as sharp as if disposable earnings were reduced, and there would be a strong incentive to increase hours and earnings to get beyond the $13,000 threshold (at which point the initial $13,000 of earnings are retained tax-free and the next $12,000 are taxed at only 15%). An additional option would be to retain or extend the current Working Credit, which allows unemployed people who find work to retain some level of benefit for a specified period of time after they commence employment.

[246] 'The welfare expenditure debate' p.19

[247] Something similar is under development which would enable people on benefits to use Centrelink debit cards to pay for supermarket purchases – Sue Dunlevy, 'Bad parents paid in food' *Daily telegraph* 15 November 2006

[248] The model here is the way exemption from the 1% Medicare Levy surcharge is organized – taxpayers furnish the ATO with details of the private health insurance policy they have bought, and the tax reduction is then triggered. It would, however, be better if tax allowances could be built into personal tax-free thresholds so that money is docked at the correct amount every fortnight through PAYG.

[249] Of course, retailers would have to separate the purchase price and tax component of the items they sell, but it would anyway be a worthwhile reform if retailers were to list the purchase price and tax separately on the goods they sell, just as they do in the USA. It is a basic and fundamental principle of any tax that it should be visible, yet in Australia, motorists are not told at the pump how much of the final price of each litre of petrol is tax, smokers and drinkers are not told how much of the final price of

their cigarettes or alcohol is made up of duties, and shoppers are not told how much of their groceries bill is made up of GST. There is a strong case for legislation requiring that prices of all goods and services should be expressed both net of taxes and gross (including taxes).