ISSUEANALYSIS

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Part III in a three part series 'Restoring Self-Reliance in Welfare'

Twenty Million Future Funds

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At least half of all welfare state expenditure goes back to the same people who contribute the money in the first place. Sometimes people pay tax and get it back straight away as benefits or services ('simultaneous churning'); sometimes they pay tax and get it back much later on ('lifetime churning'). There are strong economic and social reasons for reducing both types of tax-welfare churning, and this paper considers how this might be done.

Churning can only be reduced by allowing people to retain more of their income in return for reduced use of government benefits and services. This requires lower taxes and increased use of personal savings, loans and insurance.

The best way to reduce simultaneous churning is to raise the tax-free threshold (TFT). Low income families are then taken out of the tax system and higher income families retain more of their income so they no longer need government payments.

The key to reducing lifetime churning is to enable people to save. It is proposed that the Commonwealth Government's Future Fund should be abandoned and the money redistributed among all Australians to provide everyone with their own 'Personal Future Fund' (PFF). This would help reduce people's reliance on welfare payments and services in the following ways:

- *No more unemployment benefits:* Income from an individual's PFF could be used to cover up to 6 months of any period of unemployment (anybody still without a job after 6 months should be offered full-time Work for the Dole until they find employment). This would reduce the stigma of unemployment and strengthen job-search activity.

- *Voluntary Medicare opt-outs:* Taxpayers could be allowed to opt out of Medicare (up to an annual health expenditure limit) by making additional tax-free contributions to their PFFs. PFF money would then be used to pay for GP visits, pharmaceuticals, health insurance deductibles or direct purchase of private health care.

- *Tax-free savings:* An annual tax-free savings allowance could help younger people invest in their PFF in order to purchase a first home, education and training, or set up a business.

The paper also calls for reforms to superannuation. Tax on super contributions and on fund earnings should either be scrapped entirely, or should be removed for individuals who opt out of their entitlement to a government age pension. Retirees who do not opt out should be required to convert part of their lump sums into annuities up to the value of the age pension.

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Abbreviations

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)
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)

TWENTY MILLION FUTURE FUNDS

Introduction and re-cap

This is the final paper in a three-part series looking at how we might transform our 20th century welfare state to meet emerging 21st century needs and requirements.[1]

In the first paper in this series (*The $85 Billion Tax-Welfare Churn*) we saw that the mass welfare state came about because ordinary people could not afford to buy income insurance, retirement annuities, schooling and health care for themselves, which left them vulnerable in the face of risks like unemployment, ill-health and old age. However, greater economic stability and rising real incomes over the last 30 or 40 years have meant that many Australians should now be able to afford expenditures like these with little or no state assistance. The reason this is not happening is because of the high taxes people have to pay in order to finance the welfare state budget, which soaks up two-thirds of all government spending. We have locked ourselves into a vicious circle where escalating levels of government spending drive up taxes; high taxes reduce people's disposable incomes; lower net incomes mean people cannot afford to look after themselves; and this results in an ever-rising tide of demand for government services and even higher levels of government spending and taxation. The key policy question is how to break out of this circle before it strangles us.

It is often assumed that any attempt to reduce or replace the mass welfare state would precipitate widespread poverty and deprivation, but this ignores the fact that at least half of all welfare state expenditure finds its way back to the same people who contribute the money in the first place (so-called 'churning'). We need to find a way of reducing taxation to allow more people to fund their own needs out of their own pockets, while still collecting the revenue that is needed to help those who cannot support themselves. If we cut back tax-welfare churning, we could significantly increase rates of self-reliance without harming those who cannot look after themselves.

The second paper in the series, *Six Arguments in Favour of Self-funding*, explained why cutting churning and promoting self-reliance is so desirable. Economists warn that our high level of tax-welfare churning is expensive and inefficient, it destroys work incentives, and it threatens to spiral out of control as the population ages, but the key reasons for change are as much social as economic.

As the welfare state has expanded, it has eroded people's belief in their own efficacy. A culture of learned helplessness has been fostered in which people look automatically to government to solve their problems rather than having the confidence to solve life's difficulties themselves (if need be, with the help of family, friends, workmates and neighbours). This has politicised our society by aggregating power in the hands of government. Politicians compete to bribe electors with their own money while pressure

groups scramble to attract bigger shares of government largesse and patronage. Mass welfare has also bred suspicion and resentment among those who think they are paying too much, and encouraged anti-social and/or self-destructive behaviour among those who have lost the habit of self-reliance.

The key to reducing reliance on the government lies in reducing tax-welfare churning—that is, leaving people with more of their own money so they do not have to ask government for help. Our aim should be to restore self-reliance by leaving individuals and families as far as possible free to spend their own money to provide for themselves. Government help should be limited to topping up those who cannot provide for themselves. The question is: how are we to achieve this?

More means testing is not the answer

One obvious way to reduce churning is by tighter means testing of existing benefits and services to limit the flow of government spending to those who really need it.[2] However, Australia is already one of the most tightly means-tested welfare states in the world. We spend per capita around the OECD average on government social benefits and services, but we target this spending much more tightly than other countries do, so the middle classes get less, and the poor get more, than in almost any other comparable nation.[3]

The downside to this efficiently-targeted system is that it dramatically weakens work incentives. The inevitable result of rigorous means-testing is to reward those who fail to achieve self-reliance 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. 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 would only make this problem worse.

To extricate ourselves from this dilemma we need to think more radically about how to disentangle the tax and welfare systems so that most people do not need to be given government help in the first place. The aim should not be to *restrict* existing welfare by even more means testing, but to *transcend* it, by removing as many people as possible from reliance on the government. The way to do this is to reduce tax-welfare churning, and this will require a fundamental re-think of the purpose of the welfare state in the 21st century. In particular, we need to reconsider the principle that people have a 'right' to government support.

Giving people financial aid unconditionally as a 'right' inevitably generates problems of 'moral hazard'.

Abolish 'welfare as we know it'[4]

The principle that people in need should be able to rely on the wider community for support must be respected. Few Australians want to return to a 19th century system with little or no government safety net for those who fall on hard times. What must be re-examined, however, is the assumption that support for people in need necessarily translates into provision of welfare payments or government services. There are other ways people can be supported than by simply giving them money.

In the early days of the welfare state, reformers were concerned that state aid should not undermine self-reliance, and they drew an explicit distinction between people who 'deserved' help (widows and orphans, for example) and those who had brought misfortune upon themselves through their own recklessness or irresponsibility (for whom any help should be conditional and time-limited). Over time, these distinctions have been eroded, and the idea has taken root that the state has a duty to provide cash and services to any citizen who needs help, regardless of why they need assistance or how they behave. This rights-based welfare ethic must now be challenged.

Giving people financial aid unconditionally as a 'right' inevitably generates problems of 'moral hazard'. If you reward people who are needy you increase the supply of people claiming to be in need. More alarmingly, by relieving people of responsibility for their own actions, unconditional welfare can over time generate the very behaviour and attitudes that destroy self-reliance. In Indigenous communities, for example, reliance on what

Noel Pearson calls 'passive welfare' is implicated in the debilitating spread of substance abuse, physical violence and community breakdown. In Britain, a traditionally strong civil society has been undermined by the 'damaging belief that no matter how badly a person behaves the right to welfare is inviolate.'[5] If you do not expect responsibility of people, you end up with irresponsible people.

The principle of unconditional welfare has been challenged in Australia by the emergence of government policies based in the idea of 'mutual obligation'. This makes receipt of some cash benefits conditional on performance of some kind of activity (e.g. after six months on unemployment benefits, claimants are expected to undertake part-time training, community work or other activities). But while this insistence that recipients of benefits do something in return for the money they receive has dented the principle of unconditional welfare, it has done nothing to challenge the entrenched idea that it is the government's duty to give people cash when they need it. Welfare given in return for undertaking a training course or doing some community work is still welfare.

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If we want to develop a tax and welfare system that promotes self-reliance, the first principle must be that people who are capable of taking responsibility for themselves should be expected to do so. This means moving away from the principle of a 'right to welfare' in favour of a presumption that people should self-fund their personal needs. Before welfare payments or services are offered, the following sequence of questions should be addressed:

1) Is there some way this person might generate their own income in order to pay their own way (e.g. can they be helped to find a job)?
2) Could their future needs be met by helping them build up their own financial safety net (e.g. by saving or insuring themselves)?
3) Would it make sense to offer them a loan, repayable out of future earnings, to tide them over a needy period?
4) If none of these options is feasible, is it appropriate to require some activity from them in return for a temporary welfare payment (i.e. mutual obligation)?
5) If not, should they be offered an unconditional welfare payment on the grounds that they cannot and should not be expected to support themselves?

In a rights-based system, accessing welfare is too often the first option for assistance—somebody in need contacts the welfare system, and the system responds with the payment or service to which they are legally entitled. In a system emphasising personal self-reliance, by contrast, welfare becomes the last resort when other alternatives have been considered—somebody in need contacts the system, and the system responds by asking what help they need in order to restore their independence.[6]

The ideas that follow attempt to apply this principle of self-reliance to the main areas in which the welfare state currently operates.

Strategies for self-funded welfare

Tax-welfare churning takes two forms. There is 'simultaneous churning' (where money is taken away in tax and returned immediately to the same people as welfare state services or income transfers), and there is 'lifetime churning' (where people pay tax at one point in their lives and get it back as services or income transfers at another). To enhance self-reliance and reduce dependency on government, both kinds of churning need to be whittled down.

Simultaneous churning can be reduced by allowing people to retain more of their income in return for reduced immediate use of government benefits and services. This could be achieved, for example, by reducing people's income tax while simultaneously reducing their access to transfer payments like Family Tax Benefit (FTB). It could also be done by allowing tax concessions to those who opt out of public services by purchasing private sector equivalents. Either way, in return for reductions in their tax, people would

be expected to assume greater responsibility for taking care of their own everyday needs. This would leave the welfare state to concentrate on those who cannot afford to buy what they need by supplementing their incomes or providing government services as appropriate.[7]

Reducing lifetime churning is more complicated, for some way has to be found to enable people to spread their incomes through the lifecycle. Lifetime income flows are uneven (we generally earn more in mid-life than in adolescence or retirement), and needs are lumpy and to some degree unforeseeable (we never know when we might be ill, and we do not know how long past retirement we will need an income).

The welfare state currently manages many of these risks and uncertainties for us. The government taxes us when we are earning, and then returns the money, less overhead expenses, in cash or kind when or if we get sick, have children or retire. Some people see this lifetime churning of tax and welfare as one of the strengths of the 20th century welfare state. They do not therefore see churning as a problem, preferring to redefine it as beneficial 'consumption smoothing' by governments.[8]

What this overlooks, however, is the way a socialised system of lifetime redistribution forces individuals to pay tax into a common pool from which they can draw only when (and if) the government decides they are eligible. They have no control over their own money, and they are at the mercy of future generations of politicians and bureaucrats to decide whether their needs will in fact be met.[9] This contrasts with a privatised system of income smoothing where individuals pay money into their own accounts, which allows them to decide for themselves how much they want to set aside for the future, and to judge for themselves when they need to access it. Real security lies in personal ownership and control, not in government promises.[10]

Individuals can smooth out their incomes over time without relying on the government in three ways: they can borrow, insure and save.

There are three ways individuals can smooth out their incomes over time without relying on the government. They can borrow, they can insure, and they can save. Savings, insurance and loans are thus the three possible substitutes for the welfare state's income smoothing function, and any move from welfare to self-reliance will have to involve increased use of some or all of them.

- *Savings* are an appropriate replacement for state provision where future needs can be anticipated and planned for. For example, instead of state age pensions, people might build up personal superannuation accounts to provide themselves with a post-retirement income. They might also accumulate savings to meet the costs of everyday medical expenses, to pay for adult education or further training, to buy a house or to help with the cost of school fees for their children. Saving is not always appropriate, however. Where risks are small but potentially costly, it can be inefficient for everyone to save large sums against the off-chance that some disaster might befall them. In situations like this, insurance (pooled risk) may be a better option. Overall, however, the expansion of savings and investments is likely to prove the biggest single contributor to the expansion of self-reliance.
- *Insurance* may be an appropriate substitute for state provision in cases where individuals need to minimise their exposure to risk. In place of government sickness benefits, for example, people might take out their own replacement earnings insurance. There are, however, problems in any system of insurance that will limit the capacity of private insurers to replace state systems and still make a profit. These include 'adverse selection' (where only people seriously at risk bother to insure themselves, thereby driving up the cost of premiums—a problem that has been hindering the growth of private health insurance in Australia),[11] and 'moral hazard' (where insured people try to maximise their eligibility for benefits by increasing claims, thereby pushing up premiums). There are ways of overcoming these problems,[12] but difficulties like these mean that insurance is likely to play a secondary role in any future expansion of private self-provisioning.

- *Loans* are the mirror-image of savings, for they are an appropriate instrument for funding costs incurred earlier in life, before individuals have accumulated much capital, but when they can still anticipate many years of future earnings. Many students in higher education already take out loans to cover university fees, just as households already borrow substantial sums relatively early in life in order to buy housing, paying off the loan from later earnings. In principle it might be possible to extend the use of loans into other areas of social policy including income support (relatively brief periods out of the labour force could be covered by loans repayable when claimants get another job), although provisions would be needed to limit the growth of indebtedness before any such policies could realistically be implemented.[13]

This extensive churning not only erodes self-reliance; it also creates dispiriting work disincentives.

Note that greater use of private purchasing (to reduce simultaneous churning), together with increased use of savings, insurance and loans (to reduce lifetime churning) does not rule out a continuing role for government. Governments might top up people's purchasing power (as occurs today with the Medicare Plus price-caps on pharmaceuticals and government co-payments on super contributions), they might underwrite high-risk insurance, and they might offer tax incentives for those who opt for a private sector alternative rather than using an existing government service (the current private health insurance rebate and tax concessions on superannuation contributions are examples). Government might also use its power to require people to make provision for themselves (as is the case with the current Superannuation Guarantee), and it will always need to provide back-up help for those who cannot support themselves.

The move from a predominantly socialised to a predominantly privatised system of social support does not therefore equate to a return to the 19th century when individuals were left to make their own arrangements with little involvement by the government. We are not going backwards, but forwards, away from a system where government provides and runs a mass system of service provision towards a situation where government enables an increasingly self-reliant population to provide for itself whenever it can.[14]

For the remainder of this paper, various policy options for reducing churning and promoting greater self-reliance will be reviewed. In future work we shall develop some of these ideas in more detail while abandoning others if they are found to be unworkable or if better alternatives emerge. At this stage, it is important just to get the debate started.[15]

Reducing simultaneous churning

Family support payments (the Family Tax Benefit, Parts A and B, plus child care benefits) represent one of the main sources of simultaneous tax-welfare churning. We saw in the first paper in this series that working parents pay large sums in income tax, only to receive large sums back in fortnightly Family Tax Benefit (FTB) payments.[16] 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.

This extensive churning not only erodes self-reliance; it also creates dispiriting work disincentives. FTB payments are means tested, so as family income rises, the payments decline. But family earners also pay income tax. The combined effect of withdrawal of mean-tested welfare payments and escalating income tax payments can produce so-called 'effective marginal tax rates' (EMTRs) so high that it hardly seems worthwhile trying to increase one's earnings.

A major step in helping families regain control of their own budgets while removing the sting of tax-and-welfare claw-backs would be to raise substantially the value of the tax-free threshold (TFT). The TFT is the amount of annual income someone can earn before they have to start paying tax. It is currently set at just $6,000, which is well below subsistence level. If it were raised to a level high enough to ensure that families are not taxed until they have earned enough to meet their needs, then no family earning above

the TFT would have to resort to government aid. This would eliminate churning for all earners above the TFT, for nobody paying tax would need to receive welfare.

In previous work I have suggested that the TFT should at the very least be raised to a point above the welfare floor, for this is the minimum income the social security system defines as necessary to sustain a subsistence lifestyle. Above this level, it should not be necessary to top up people's incomes with additional welfare payments.

Given the value of current welfare benefits, this proposal would translate into individuals being allowed to earn around $12,500 per year before paying any tax, and couples who opt to be taxed jointly (probably one-earner couples) sharing a $19,500 annual tax-free allowance between them. To provide additional help for families with dependent children, these TFT levels could be supplemented if children were given their own tax-free allowances. These could then be claimed on their behalf by one or both of their parents. For example, if children qualified for a $10,000 TFT, a single-earner couple with two children could earn $39,500 before starting to pay tax (the couple's allowance is $19,500, plus they claim two children's allowances of $10,000 each). They would not then receive any additional government payments because they would not need to—they could meet their basic needs out of their own (tax-free) income.[17]

A recent paper by John Humphreys has outlined a much more radical proposal, albeit one based on broadly similar principles.[18] He wants to reform the whole benefits system (unemployment allowances, Parenting Payments, Disability Support Pension, Youth Allowance), not just family payments. To this end, he suggests raising the TFT for individuals to $30,000, and linking it to a Negative Income Tax (NIT) which would be paid to individuals with incomes below this threshold. This NIT would replace *all* existing welfare payments. Humphreys proposes a flat rate 30% tax on income above $30,000, and a Negative Income Tax top-up of 30% on incomes below it.[19]

The strength of this proposal is that it would ensure that nobody would lose more than 30 cents on any additional dollar earned, for those below the threshold would get topped up at a 30% rate, and those above it would pay tax at a 30% rate. This would not only remove most working families from any reliance on government cash handouts, but it would also maintain strong work incentives for those below $30,000 who are in receipt of government payments.

All these proposals are subject to further refinement and revision, but for the purposes of this paper what matters is the basic principle behind them. This is that, as far as possible, we should seek to disentangle the tax and welfare systems by raising the TFT in order to take low income families out of the tax system altogether. Humphreys's suggestions are particularly attractive because they would *completely eliminate* tax-welfare churning. Under his scheme, people earning adequate incomes would cease to receive any government payments, but they would also pay much less tax, which means they would be able to support themselves and their dependents without needing government help. This is precisely the outcome we need to be aiming for.

If people had their own assets, they would not need to seek income relief or 'free' government services every time their earnings were disrupted.

Reducing lifetime churning

The 20th century welfare state sought to safeguard the population from serious deprivation by providing people with income or services when they needed help. It paid little attention, however, to how people might build up their own capital so they could draw on their own resources when times get hard. This oversight has made mass dependency inherent to our present welfare system, for as soon as somebody's income dries up—they fall sick, lose a job or retire—they have no option but to depend on the government to provide the money and services they need.

If people had their own assets, they would not need to seek income relief or 'free' government services every time their earnings were disrupted. They would be in a position to meet their needs from their own resources. Former Labor leader Mark Latham understood this when he argued that any policy aiming to bolster self-reliance must think about how to 'move from a system of recurrent income transfers to one based on asset

accumulation.'[20]

One obvious example of how asset-building can reduce dependency on government is Australia's Superannuation Guarantee (SG) scheme. As workers build up their own retirement funds, so they should need to rely less on the state age pension when they retire.[21] There is no reason in principle why the same 'virtuous circle' should not also develop in other areas such as health care (where there have been suggestions that personal medical savings accounts might reduce reliance on Medicare)[22] or income support (where unemployment savings accounts have been proposed to replace government unemployment allowances).[23]

For any of this to happen, individuals must be allowed to build up and control their own assets in their own personal accounts. Many will not be in a position to do this unless their taxes are lowered. Yet current federal policy is taking us in precisely the opposite direction. Personal and retirement savings are being severely taxed (thereby reducing people's ability to build up sufficient funds to ensure their own independence), and to add insult to injury, it is the Commonwealth Government that is busy building up its own savings fund using money taken out of individual taxpayers' pockets!

The only reason the government has budget surpluses is because taxes are too high.

In 2003 the federal government announced it was establishing a 'Future Fund', into which will be tipped the proceeds from the final privatisation of Telstra as well as future budget surpluses. At its inception in early 2006, this fund will contain $18 billion of taxpayers' money.[24] Following the sale of Telstra (expected to generate at least $27 billion) it is estimated that it will reach $62 billion by June 2007, and some predict it could get as high as $90 billion as early as 2008.[25] Far from cutting taxes to enable people to save, the federal government is therefore busy taxing people *more highly than it needs to* and is diverting the surplus into its own piggy bank.

The government says it needs this money to pay for under-funded, defined-benefit public service pensions falling due after 2020, but this claim is not convincing. While the cost of health and age care will rise in the next few decades as the population ages, the cost of public service superannuation is actually forecast to *fall* as a percentage of GDP (from 0.6% in 2001/02 to 0.3% in the period 2021-42). Yet nobody is suggesting that a special fund be built up to pay for future health and age care liabilities. The former Secretary to the Treasury, Ted Evans, points out that the best way today's population can help future generations meet their liabilities is to increase the size of GNP, and the way to do this is to encourage individuals and businesses to invest. Taking money out of the private economy and stuffing it under the government's mattress may leave future generations worse rather than better off.[26]

The government's Future Fund is really a way of soaking up budget surpluses and locking away privatisation proceeds at a time when the public debt has all but been repaid.[27] But the only reason the government has budget surpluses is because taxes are too high. A better alternative to the Future Fund would be to hand back the surpluses to the taxpayers who are funding them, and to remit future receipts from the sale of Telstra to the Australian public who notionally own these assets. In this way, the government could enable ordinary people to start saving for their own futures, rather than have the government doing it for them.

Twenty million 'future funds'

The Future Fund is expected to exceed $60 billion by mid-2007. An equal share-out among all permanent residents in Australia (children as well as adults) could at that time provide everyone with their own personal 'future fund' (PFF) worth around $3,000.[28] Further dividends from the Government as it disposes of surpluses in the future, together with contributions from individuals themselves, could swiftly raise this to around $5,000 per person.

Children's funds would have to be invested in trust until they reach school leaving age,[29] but adults should be free to access their personal funds in order to reduce their present or future reliance on government benefits or services. The actuarial justification

for distributing government assets to private citizens is precisely that it should reduce claims on government revenue in future years.

There are various ways this might happen. Personal Future Funds could be used as substitutes for government unemployment benefits, or they could help reduce the level of demand on government health services. They could also bolster private retirement funds (for money remaining in funds at retirement could be rolled over into superannuation accounts), and they could perhaps provide a long-term savings vehicle for those saving to buy a home, start a business or undertake training. All of these possibilities are explored in more detail below.

Some people would probably want to build up the value of their PFFs beyond $5,000, but others would be content to leave them at a minimum level. This would be for individuals to decide. All that should be required as a condition of accepting government seed money to set up a Personal Future Fund is that the value of the fund should be kept topped-up to its original, indexed value until retirement age. In other words, as and when money gets used, it should be replaced out of later earnings.[30]

Everyone would have savings sufficient to maintain themselves at subsistence level for almost half a year if they found themselves jobless.

Using the PFF: (1) Substitute for unemployment benefits

Six months of a single person's basic unemployment allowance is currently worth around $5,200—more or less the same as the proposed minimum value of a PFF once the system is mature. This means everyone with a PFF would have access to savings sufficient to maintain themselves at subsistence level for almost half a year if they found themselves jobless and with no other source of income.

The establishment of PFFs could therefore enable existing unemployment benefits (Newstart, plus the Youth Allowance for younger jobseekers) to be scrapped. Given that the minimum value of a PFF will be sufficient to replace the basic unemployment benefit for six months, anybody losing a job and registering as unemployed could draw down on their personal fund to provide themselves with a basic income for the first 26 weeks rather than seeking government assistance (additional income to support the cost of dependents would be made available through existing welfare payments or a replacement NIT).

Most people who lose a job find another within eight weeks,[31] so most unemployed people would need to use only part of their funds, and would be able to top them up again fairly quickly once they resumed working. Where a spell of unemployment lasts for more than six months, however, or where there are repeated spells within a relatively short period, funds would become exhausted. At this point, assuming they have not insured themselves privately against loss of income, people requiring financial assistance could apply for full-time 'Work for the Dole' (WfD). This would provide them with a replacement income until they find employment (this proposal has been outlined more fully elsewhere).[32]

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 disappear, and accusations of 'dole bludging' would lose their bite, for the cost of any laziness or work avoidance would fall solely on the unemployed person themselves. And because there would be a strong motivation to find work 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 or even eliminated. 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.

There would also be substantial savings on the government's welfare budget, for not only would short-term unemployment support be self-funded, but long-term unemployment (funded through WfD schemes) would almost certainly fall. Under our existing system, where there is no time limit on receipt of unemployment benefits, some claimants maintain unrealistic expectations about the kind of work or income they are willing to accept, and others hold out too long time for 'the right job' when they would

be better off taking a less-than-ideal position. Knowing that their PFF is running down, these jobseekers would likely be more flexible when assessing employment opportunities, and this would reduce the drift into long-term unemployment, possibly cutting the figures by as much as 200,000.[33] Meanwhile, the offer of a full-time WfD place would still guarantee a safety net for those who do remain jobless for an extended period.

Using the PFF: (2) Medicare opt-outs

In addition to replacing unemployment benefits, PFFs would also have the potential to reduce people's dependency on Medicare benefits and other government-subsidised health services like the Pharmaceutical Benefits Scheme (PBS) or public hospitals. With adequate savings, people could in principle meet many of their everyday medical expenses (like a visit to the GP or purchase of prescribed drugs) without needing government reimbursement or subsidy, and they might even be able to access more expensive treatments including private hospital care. All this would help reduce projected future government health spending (a much bigger liability than the projected deficit on public service superannuation).

With adequate savings, people could in principle meet many of their everyday medical expenses without needing government reimbursement or subsidy.

While Medicare continued in its present form for those who wanted it, everyone could be offered the choice of tax reductions in return for accepting greater responsibility for their own health care costs. Adults opting for this could be allowed to make tax-exempt additional contributions into their PFFs (or into a mutual fund offering comparable benefits if that is what they preferred)[34] sufficient to cover their medical expenses up to an agreed annual ceiling.

For example, individuals might agree to fund their own GP and pharmacy expenses up to an annual total cost of, say, $2,000 (which would more than cover the average per capita level of GP and PBS benefits currently consumed).[35] They might in return be entitled to make additional deposits into their personal funds of up to, say, $5,000 per year free of tax. Assuming a 30% tax rate, this would be worth $1,500 to them in tax saved, and even allowing for periodic routine medical expenses, they should find that over time they could build up the value of their PFF funds. Any money not used for medical expenses in any one year could be left to accumulate to be used for medical or any other approved purpose later on.

Personal funds might also be used to reduce the cost of private health insurance premiums, thereby making private health care more accessible for a greater number of people. If policy holders were able to tell insurers they can pay, say, the first $3,000 of any hospital treatment using their PFFs, their insurance premiums would be much lower. By opting out of their entitlement to public hospital care in return for tax exemptions on payments into their personal funds, people would be able to meet these higher deductibles out of their savings, and this could enable them to buy much cheaper insurance.[36]

Alternatively, people opting out of the public hospital system might choose to do without health insurance and instead to build up their savings so they can pay hospital bills (up to a certain limit) directly out of their own funds when the need arises. One of the inequities in the existing system is that health insurance attracts a tax concession of 30% while those who prefer to purchase private medical treatment outright are ineligible for any tax reduction.[37] If all health-related contributions to a PFF attracted the same level of tax exemption, this bias in favour of insurance would be overcome.

Allowing people to make additional tax-free contributions into their PFFs to reduce their reliance on Medicare and the public hospitals 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, for 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 and is likely to promote the take-up of preventative measures and healthier lifestyles.[38]

Using the PFF: (3) Pre-retirement asset purchases

Personal savings are taxed punitively in Australia. Workers first pay tax on their earnings, and then if they put any post-tax money aside, the interest it earns gets taxed again at their highest marginal rate.[39] A 2002 Senate inquiry into taxation of savings and superannuation recommended the introduction of 'a tax-preferred medium to long-term savings vehicle which could be accessed prior to retirement for purposes such as health; savings for a home deposit; and education', but this recommendation has been ignored.[40]

There is a strong case in principle for allowing people to make limited tax-free payments into their own long-term savings accounts which could be used to fund asset purchases that would enhance their self-reliance later on. Saving towards the purchase of a first home, establishment of a small business, or purchase of vocational training that will lead to a higher earning capacity are all examples of how people's capacities to look after themselves might be enhanced. Individuals might be allowed to transfer a limited amount of taxable income tax-free each year into their PPF with the proviso that this money could only be used for specified kinds of purchases, such as home ownership or an accredited training scheme. For those earning less than their TFT, it might also be possible to institute a 'matched savings' scheme based on the equivalent of the 30% tax allowance enjoyed by those earning above it.[41]

There are a number of practical issues which would need to be addressed before this particular proposal could be instituted. In particular, overseas experience suggests that monitoring the use of withdrawals could prove problematic, and this difficulty would have to be resolved before a scheme like this came into operation. In principle, however, it makes sense to encourage individuals to save for asset purchases that will enhance their autonomy, rather than having the government do the saving for them in its own Future Fund.[42]

It makes sense to encourage individuals to save for asset purchases that will enhance their autonomy.

Reform superannuation

Establishment of PFFs could help reduce churning during people's working lives, but when it comes to retirement, most people already have their own superannuation savings funds which should reduce their reliance on government age pensions. At a time when many other countries are grappling with the implications of an age pension explosion as their population ages, Australia is fortunate to be almost fifteen years into a privatised retirement funding scheme (the Superannuation Guarantee) which will take some of the pressure off government-funded pensions in future years. Having said that, however, the SG system in Australia has several important weaknesses that need fixing if it is to replace mass dependency on the age pension.

First, the 9% salary contribution is probably 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.[43] Secondly, the 9% contribution is currently made solely by employers with nothing coming from employees (unless they choose to make additional contributions), thus weakening the sense of personal responsibility for one's 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.[44] Fourthly, accumulation of capital in funds is hampered by a tax regime which reduces 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.[45]

Several of these problems could be fixed by removing tax on super contributions.[46] Despite the removal of the superannuation surcharge on top-rate taxpayers in the 2005 budget, superannuation is still slugged heavily by taxation. Indeed, Australia is unique in taxing superannuation at three different points (contributions, earnings and withdrawals).[47] The government is able to get away with this because contributions are compulsory, but the government's tax greed drives down people's ability and willingness voluntarily to put aside additional funds for their retirement.

One way to encourage employees to build up their super funds would be to scrap

the 15% tax on contributions. This would help defray the impact of higher saving on net take-home wages (for an additional contribution of, say, 6% of salary would reduce take-home wages by less than 3%). If the tax on fund profits were also abolished, future claims on the government age pension could be significantly reduced by boosting the value of people's super funds to a more adequate level (super would only be taxed once, when it is drawn down as income after retirement).

A major problem with this proposal is that the federal government has become accustomed to receiving a steady flow of revenue from its taxes on super. Taxation receipts from super contributions and earnings now account for 2.8% of all tax revenues, fuelling suspicions that the federal government has become too dependent on its superannuation tax haul.[48]

An alternative to scrapping super tax altogether would be to offer superannuation tax concessions only to workers who opt-out of any future age pension entitlement. For example, workers might be allowed to contribute up to, say, 10% 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 parsimonious 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 may well be attracted to the opt-out. The result would be a substantial reduction in lifetime churning and a significant drop in the projected level of future government spending on the ageing population.

Future claims on the government age pension could be significantly reduced by boosting the value of people's super funds to a more adequate level.

Boosting the value of people's super funds would not, however, do anything to mitigate the moral hazard problem at the heart of the existing system. At present, by cashing in their superannuation lump sum and disposing of it, retirees can maximise their eligibility for the means-tested government age pension. This problem needs to be tackled by requiring people who have not opted out of their entitlement to the age pension to convert part of their super lump sums into annuities when they retire. The proportion of the lump sum converted into an annuity should be sufficient to generate an income comparable to a full age pension (which would preclude eligibility for the means-tested pension). Any surplus could then be taken as a lump sum with no restriction on how the cash is spent.

Costs and implementation

Faced with a set of radical reform ideas like these, critics will immediately claim that it is all too 'expensive' (meaning that government will lose too much revenue). It has been estimated 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.[49] There would, of course, be big savings through the scrapping of FTB, and there could also be substantial savings from people opting out of government benefits like the age pension or Medicare, but many of these would not accrue to governments for some years. All in all, these proposals threaten to carve a big slice out of the government's existing budget, and this is bound to prompt the worry: is it 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 and raising self-reliance is that tax revenues should drop substantially while people 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.

There can be no clear answer to this without detailed analysis of the various policy alternatives (and even then, revenue and expenditure models are only as good as the behavioural assumptions that are built into them). If implemented, the ideas outlined in this paper could result in a big fall in the number of long-term unemployed, a major increase in work participation among single parents, 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 the impact of these changes (both short-term and long-term) cannot be determined in advance, for reforms on this sort of scale have never been tried before in this country.

Cautious politicians and bureaucrats will be understandably wary of change of this magnitude if it looks like a leap in the dark. One solution could be small-scale experimentation so we can see what works, what does not, and how much different policies are likely to cost. The best way to see if the ideas set out in this paper are practical would be to see what happens when they are put into practice under varying conditions in different parts of the country.[50]

Conclusion

The ideas outlined in this paper might sound radical, yet little of this is really new, for 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. All employees now have personal retirement accounts. Students routinely pay higher education course fees by borrowing and repaying their HECS loans from future earnings. And the majority of households have taken out loans to cover house purchase.

For too long, our tax system and our welfare state have been locked together in a crazy jig.

The policy challenge is how to support and extend this practice 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 the majority of parents to be getting government family and child care benefits, or for one in six working-age adults to be wholly reliant on government welfare payments to give them an income. For too long, our tax system and our welfare state have been locked together in a crazy jig, twirling each other ever faster towards ultimate collapse and exhaustion. Both stand in need of radical reform, and they must be reformed together—not by fiddling with a tax rate here, or meddling with a welfare benefit there, but by restructuring the way tax payments are made and welfare benefits are given so that our capacity for self-reliance is maximised rather than constantly being thwarted by the inexorable expansion of government.

Endnotes

[1] Thanks to Ian McAuley and Helen Hughes for invaluable comments on an earlier draft. Responsibility remains that of the author.

[2] 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.

[3] Peter Whiteford, *The Welfare Expenditure Debate: Economic myths of the left and right revisited* (Paper to SPRC conference, Sydney, 20-22 July 2005).

[4] It was President Clinton who promised Americans he would 'abolish welfare as we know it.' See Peter Saunders, *Australia's Welfare Habit: And how to kick it* (Sydney: Duffy & Snellgrove, 2004), chapter 4.

[5] Frank Field, *Neighbours from Hell* (London: Politico's 2003), 98; Noel Pearson, *Our Right to Take Responsibility* (Cairns: Noel Pearson & Associates Pty Ltd, 2000).

[6] This is similar to Wisconsin's principle of 'diversion'—the idea that every other option should be explored before somebody enrolls on welfare. See Lawrence Mead, *Government Matters: Welfare reform in Wisconsin* (Princeton University Press 2004). Mead notes of Wisconsin's experience of welfare reform: 'Helping people, even generously, was not counter-productive as long as those aided also helped themselves'.

[7] Our existing tax-welfare system contains various examples of tax concessions for those who pay for private provision, and welfare provisions or income top-ups for those who do not. Working parents can claim a child care allowance against their taxable earnings, for example, while those on low incomes are eligible for a child care benefit, paid to their service provider to reduce the fees they have to meet (in reality, many parents get both). There are also parallel systems in housing and health care. People who buy their own housing enjoy various tax breaks and concessions, including exemption from taxation on capital gains and on the imputed rental value of their homes, and those who rent privately benefit from tax breaks to landlords such as negative gearing (passed on in lower rents). Low income households, by contrast, are given rent rebates to top up their ability to pay for suitable accommodation. In health care, people who buy private health insurance receive a tax rebate on their premiums—i.e. in return for removing themselves from the state hospital system, they are allowed to keep more of their income to help them pay for their private cover—while those without access to private insurance use the welfare state's public hospitals when they need medical care.

[8] 'Even if all poverty and social exclusion could be eliminated, so that the entire population were middle class, there would still be a need for institutions to enable people to insure themselves and to redistribute over the life cycle… The welfare state has a major and continuing role in facilitating insurance and consumption smoothing' Nicholas Barr, *The Welfare State as Piggy Bank* (Oxford University Press, 2001), 1-7.

[9] We might, for example, assume that our taxes will provide us with an age pension at 65, but concerns about the ageing population could well encourage future governments to raise the retirement age. Similarly, we assume our taxes (and the Medicare levy) will ensure adequate health and age care when we get older, but we are entirely at the mercy of future government decisions about health funding and allocation.

[10] Hilaire Belloc understood this. When the UK government took over responsibility for unemployment insurance before the First World War, Belloc ruefully observed in his book, *The Servile State*: '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.' (quoted in Theodore Dalrymple, 'Roads to serfdom', *City Journal*, Spring 2005).

[11] See James Butler, *Private Health Insurance: Policy change and private health insurance: did the cheapest policy do the trick?* (Australian Healthcare Association, 2002).

[12] For example, everyone can be required by law to insure in order to overcome the first problem, and they can be offered no-claim incentives, or required to pay a 'deductible' on any claim, to help with the second.

[13] I floated the idea that loans might replace some welfare payments in Peter Saunders, 'A Cinderella story for the modern welfare state', *The Age*, 2 November 2005.

[14] On the transition from a 19th century 'market' system of welfare to a 20th century 'socialised' one, and from there to a 21st century 'privatised' system, see Peter Saunders, *Social Theory and the Urban Question* (2nd edn), London, Unwin Hyman, 1986, 312ff.

[15] Earlier CIS publications have looked at education reform in some detail, arguing for tax credits as the principal mechanism of school funding, and for competitive, fee-based higher education coupled with selective subsidies and loans for students.(see Jennifer Buckingham, *Families, Freedom and Education,* Policy Monograph 52 (Sydney: CIS, 2001); Andrew Norton, *The Unchained University,* Policy Monograph 56 (Sydney: CIS, 2002). We shall therefore leave education reform on one side in this paper and focus on how the other two key welfare state budget items might be reformed: the income support payments system (including family support payments and the age pension) and health care (including Medicare benefits, public hospitals and the Pharmaceutical Benefits Scheme).

[16] 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.

[17] On shared family taxation see: Terry Dwyer, *The Taxation of Shared Family Incomes* (CIS Policy Monograph No.61,

March 2004). On raising the tax-free threshold and giving children their own threshold see: Peter Saunders and Barry Maley, *Tax Reform to Make Work Pay* (CIS Policy Monograph No 62, March 2004).

[18] John Humphreys, *Reform 30/30: Rebuilding Australia's Tax and Welfare Systems* (CIS Policy Monograph, No.70, November 2005).

[19] Humphreys does not pay much attention to the question of helping families with the costs of raising their children (indeed, he expresses the view in an Appendix that children should be seen as 'private goods' and that parents should therefore meet the full cost of raising them). However, he accepts that politically, it would not be possible to scrap family support entirely, and he gravitates to a solution much like that in my own work with Barry Maley—namely, an additional TFT component for each child (Humphreys suggests $6,000).

[20] Mark Latham, 'The myths of the welfare state' (Paper to the *Towards Opportunity and Prosperity* conference, University of Melbourne, 4-5 April 2002), 13.

[21] 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).

[22] Allen Consulting Group, *Medical Savings Accounts: A discussion paper* (Report for Medicines Australia, Melbourne, June 2005).

[23] 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.

[24] Fleur Anderson, 'Extra $2bn to seed Future Fund' *Australian Financial Review,* 7 December 2005

[25] 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.

[26] See: Australian Chamber of Commerce and Industry, *The Future Fund is Not the Best Use of Budget Surpluses* (Canberra: ACCI, 2005).

[27] 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.

[28] Labor MP Lindsay Tanner recently proposed something similar, suggesting paying this money into people's super funds ('Excess slush a perfect plug for super hole', *The Australian,* 4 May 2005. But this would exclude the non-employed population, many of whom will have contributed to these funds in the past, as well as missing the opportunity to extend the principle of promoting self-reliance through personal saving beyond the funding of retirement into other areas.

[29] In later years, newborn children could be endowed with a PFF of equivalent value, while new immigrants would be required to establish a fund of their own before taking up residence. According to the ABS (Cat.No 3301.0), 251,000 births were registered in Australia in 2002. Assuming approximately quarter of a million children born each year, an indexed endowment of $5,000 to fund each of their PFFs would involve a cost to government of around $1.25 billion annually in today's prices.

[30] When somebody uses their fund and it drops below this minimum level, they could be required to pay a small levy (say, 10% on top of their income tax) to bring it back up to the minimum value as soon as they started earning enough to do so.

[31] ABS, *Australian Social Trends 2002: Work, underutilised labour, searching for work.*

[32] Peter Saunders and Kayoko Tsumori, *How to Reduce Long-Term Unemployment,* Issue Analysis 40 (Sydney: CIS, September 2003).

[33] In *How to Reduce Long-Term Unemployment* we estimate that a 6 month time limit on receipt of unemployment benefits could reduce long-term unemployment by 200,000. 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.

[34] Noel Pearson has argued for a communal opt-out from Medicare for the indigenous communities of Cape York (*Welfare Reform and Economic Development for Indigenous Communities,* CIS lecture, Sydney, 25 October 2005) and Vern Hughes has made a similar case for any Australians wishing to form or join health cooperatives ('A cure for health care' *Policy* (Autumn 2004), 22-27). If individual opt-outs were possible, of course, it would be for individuals to decide whether to run their own health funds, insure commercially, or join a mutual aid organisation.

[35] In 2003-04 the average per capita value of the Medicare Benefits Schedule (covering GP and related services) 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) is 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. On average, therefore, somebody looking to take care of their own health expenses would need to set aside around $1,100 per year more than they currently spend. However, averages like this are

misleading, for the distribution is likely to be heavily skewed. A lot of people probably spend a lot less than this every year while a few spend a lot more.

36 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).

37 See Ian McAuley, 'Private health insurance: Still muddling through' *Agenda* 12 (2005), 159-78. McAuley warns against promoting private health insurance through tax concessions because of problems of adverse selection and moral hazard in private insurance schemes, and he points to the inequity of tax concessions for insurance when those who pay for private care outright get no such assistance: 'If a government wishes to encourage self-reliance, a starting point would be to give the same or greater incentives to those who pay for private hospitals from their own resources as they do to those who depend on private insurance' (173).

38 There would also need to be some supply-side reforms to make the market for health services work more efficiently. Restrictions on GP numbers and the distortions imposed by the Royal Colleges should be tackled, as should the anti-competition protection currently enjoyed by pharmacies (I am indebted to Ian McAuley for making this point).

39 John Ballantyne describes this as 'pernicious double taxation' ('Time to abolish income tax?' *News Weekly,* 29 January 2005, 6). He proposes a Savings-Exempt Income Tax, where tax is levied only on that part of a person's income that is spent, exempting the part that is saved or invested.

40 *Superannuation and Standards of Living in Retirement*, Commonwealth of Australia, December 2002, (para 14.13).

41 For an outline of how matched savings accounts work in other countries, see Allen Consulting Group, *Asset-based Policies: Matched Savings Accounts* (Sydney: Chiefly Research Centre, September 2003). See also: David Skilling, *Opportunity for a Lifetime*, New Zealand Institute Discussion Paper 2 (April 2005).

42 See Australian Chamber of Commerce and Industry, *The Future Fund is Not the Best Use of Budget Surpluses.*

43 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 2002.

44 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.

45 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.

46 This contradicts the proposal in John Humphreys's recent CIS paper which suggests scrapping all tax allowances, including the superannuation tax exemption. Humphreys points out that a much higher TFT would have the effect of reducing tax on super contributions for many low income workers despite the abolition of the super tax concession. However, those with higher incomes would have less disposable income available for super savings under his proposal, and they are the key group we need to wean away from use of the government age pension. Full-rate taxation of super fund earnings under his proposal would also reduce the size of people's eventual lump sums since it would eat into the beneficial effects of compound interest over a long period.

47 Alan Kohler, 'Three cheers for fiddling', *The Sydney Morning Herald,* 18 May 2005.

48 Neil Warren, *Tax: Facts, fiction and reform* (Sydney, Australian Tax Research Foundation, 2004), 178.

49 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.

50 Preceding the U.S. Federal Government's reform of welfare in 1996, states were given permission by Washington to experiment with a range of policy initiatives, and the eventual national-level reform was based on what had been learned. This capacity to experiment is one of the major advantages of a federal system of government, but it is one that Australia rarely exploits. With only six states and two territories, experimentation at state level may be less feasible here than in the USA (and varying the tax and welfare rules across states may even be unconstitutional in Australia). But we could examine the possibility of local and regional, as well as state, level policy experiments.

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