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A Welfare State for Those Who Want One, Opts-outs for Those Who Don't

Peter Saunders

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This paper looks at how the long-term growth of government spending, and the erosion of personal responsibility that this creates, might be reversed by allowing people to opt out of the welfare state. Those who prefer to pay higher taxes in return for government services and payments could still do so, but those who are willing to give up their eligibility for certain government benefits or services could reduce their income tax in return for agreeing to take more responsibility for themselves. The proposals, which are intended to generate further discussion, are:

- All adults would have the right to opt out of some of their welfare state entitlements in return for tax reductions (but those who wish to remain in the state system would be free to do so). Voluntary opt-outs would apply to the age pension and the government health system (Medicare, the Pharmaceutical Benefits Scheme and the state hospitals). Those opting out would be required to make alternative provision for themselves and their dependants using some combination of personal savings and insurance.
- Those opting out would be compensated by income tax reductions to enable them to retain more of their own money to spend on meeting their own needs. Tax would still be spent supporting the needs of poorer households, but less tax money would be 'churned' back to affluent households who do not need support.
- Government benefits for the first six months of unemployment or sickness in any year would be ended. Instead, every Australian would have a new savings account, called a Personal Future Fund (PFF), and would draw on that to cover short periods of joblessness. The federal government's Future Fund would be closed and the money transferred to 20 million new PFF accounts. Employed adults would be required to make an annual contribution to their PFF, compensated by a corresponding tax reduction.
- People wishing to opt out of government health services would make additional contributions into their PFFs, to pay for routine medical expenses, and would buy catastrophic health insurance. These additional expenditures would qualify for corresponding tax reductions up to an agreed annual limit.
- People opting out of their age pension entitlement would be eligible for tax-free superannuation contributions. Those who decide not to opt out of the age pension would be required to convert some or all of their super lump sum into an annuity generating an income equivalent to the age pension income test eligibility limit.

The paper also looks at ways in which low income groups who pay little income tax might nevertheless be enabled to cash in their welfare state entitlements so they too can opt out of the system if that is what they prefer to do.

Professor Peter Saunders is social research director of The Centre for Independent Studies and author of *Australia's Welfare Habit, and How to Kick It*.

Introduction: Where do we want to be in 2040?[1]

Most political debate and discussion is taken up with immediate concerns and short-term problems. Sometimes, though, it is important to stand back from the details that preoccupy us today and think strategically about where we hope we are going in the long-term.

When we do this, one of the core questions we have to address concerns the role and size of government. Government has become much bigger over the past forty years, and its growth shows no sign of slowing. The main driver has been the inexorable increase in spending on the welfare state (not just cash benefits, but also services like health and education), which soaks up more than two-thirds of all government spending. Even though the population is getting more affluent, and should therefore be more capable of looking after itself without government assistance, the welfare state keeps getting bigger.

Forty years ago, only 3% of working-age adults relied on welfare payments as their sole source of income; today it is around 16%

Forty years ago, state and federal governments in Australia absorbed just over one-fifth of the country's output in taxes. Since then government has increased its share of the country's GDP by another 50%. This is mainly because of the growth of the welfare state. Forty years ago, only 3% of working-age adults relied on welfare payments as their sole source of income; today it is around 16%. Forty years ago there was no government Medicare system, although the Commonwealth did help out with people's medical bills. Today, total government spending on health and aged care exceeds $80 billion per year and is still escalating at a rate of 4% per year in real terms.

How far are we prepared to let these trends go before we decide they have gone too far? If we could specify how we would like Australia to look towards the middle of this century, would we choose to have government absorbing half of everything we produce, or think it desirable to have large swathes of the population dependent on government services and government hand-outs? Or would we prefer to see an affluent country where most people manage their own affairs without having to rely heavily on government to provide them with what they need? If the latter, then we have to make changes now to set the foundations for a more responsible and freer country in thirty or forty years time. This paper is an attempt to get this discussion started.

Reducing tax-welfare churning

The core of these changes must involve action to reduce tax-welfare churning—the way government takes money away from us in tax, only to return it as welfare benefits or services. In three previous papers I have suggested that half or more of the money spent on the welfare state is 'churned' back to the people from whom it comes, which means only half is redistributed from richer to poorer households in the course of their lives.[2] I argued that if we could reduce the churning element, we could leave people with more of their own money so they would not have to ask government for help, while still redistributing resources to those who need them. The question is: how are we to achieve this?

One important step is to raise the tax-free earnings allowance so that people do not pay income tax at the same time as the government is topping up their incomes with welfare benefits. The family support payments system also needs to be amended so that welfare payments like the Family Tax Benefit and Child Care Benefit are replaced by child tax credits. Both these changes would allow families to retain a larger slice of their own earnings rather than receiving government payments. Both proposals have been outlined in detail elsewhere, and I shall not discuss them again in this paper, but they remain crucial elements in the strategy to reduce tax-welfare churning and restore self-reliance.[3]

The proposals developed in this paper would complement these tax and family benefits changes by enabling people who do not need government help to opt out of the welfare state in return for tax reductions. The paper discusses various ways in which people might take more responsibility for their own lives, rather than relying on government services and hand-outs, and at this stage, these proposals are not firm recommendations, but merely ideas intended to start a debate. However, something along these lines needs to be done if we are to encourage people who can to take more responsibility for themselves.

Will they jump or do they need a push?

There are two ways to help people reduce their dependency on the welfare state and increase self-reliance. You can push them or you can coax them. Existing government policies contain elements of both strategies.

When it comes to retirement savings, for example, we push people more than we coax them. Workers (through their employers) are forced to put money into personal superannuation, and these savings then 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 penalised with a 1% Medicare Levy surcharge. People with private health insurance do not opt out from the public health care system, for they could still use a public hospital if they wanted to, and even when they use a private hospital, the costs of their treatment are still subsidised 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 are allowed to retain more of their private income free of tax to help them pay for their private cover.[4]

Voluntary opt-outs would allow people who agree to take more responsibility for themselves to retain more of their income to enable them to do it

The proposals that follow represent a combination of pushing and coaxing, but the core idea is to offer people the choice between staying in the welfare state or opting out of it.[5] Voluntary opt-outs would allow people who agree to take more responsibility for themselves to retain more of their income to enable them to do it. Those who prefer to remain in the welfare state system can do so, but those choosing to opt out could 'cash out' some or all of their current welfare entitlements in the form of tax reductions. This could apply, not only to health care, but also to other government welfare services including retirement pensions.

Entitlement opt-outs or Contribution opt-outs?

The idea of opt-outs is not new. Prominent 'centre-left' Australian thinkers like Vern Hughes and Noel Pearson have recently suggested that people might be allowed to cash out their entitlements to Medicare and subsidised pharmaceuticals, as well as treatment in public hospitals.[6] Hughes, for example, proposes that individuals should be permitted to divert their Medicare contributions, plus their share of expenditure on public hospitals and the PBS, 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 proposals and the ideas I shall outline in this paper. One is that my proposals 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 I would only allow them to withhold part or all of their *contributions*. The entitlements opt-out favoured by Hughes and Pearson 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 towards them. 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.

This paper favours a contributions opt-out model, although later I shall also outline an alternative strategy for entitlement opt-outs. The pros and cons of each of these approaches will need to be debated, but the key point for now is that we need to agree in principle to move towards some system of opting out. Either of the models would be preferable to current arrangements, for they both allow people a choice where none is currently available.

Why should people who do not want what the government is providing nevertheless be forced to pay for it?

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.[7] 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.

Adverse selection and deadweight costs

One concern about contributions opt-outs is the worry 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.

This would not be a problem, however, if affluent people withheld money to finance their own needs but 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.[8]

I noted in an earlier paper that about half of all the money spent on the welfare state at the moment is redistributed from richer to poorer households, while half of it is churned back to the same people who provided the money in the first place.[9] The redistributive component 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 this change.

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 is that many Australians are already deserting the welfare state without opt-outs, so why should government 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 40% 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 who do not want what the government is providing nevertheless be forced to pay for it? As I have been arguing for the last twenty years, Western welfare states are undergoing a long-term process of privatisation reflecting rising real incomes and a revolution in popular aspirations and expectations.[10] Given the opportunity, most people prefer to spend their own money buying the services they want—they vote with their feet. The problem, though, is that many are not given this opportunity. Tax is taken from them whether or not they want what the government is offering them, and this leaves them with insufficient 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 model by forcing people to pay for it even when they do not want it, but how we might enable more people (especially those in lower income households) to exercise the sorts of choices that more affluent people are already enjoying?

Empowering the poor

The problem in extending choice to lower income households is that many of them are not (or do not seem to be) paying enough income tax to enable them to trade off their welfare state contributions against tax reductions. Even in the middle of the income distribution, people with families often find they are getting more out of the system than they are putting in.

Estimates by the National Centre for Social and Economic Modelling suggest 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 family payments claimed by those with dependent children) as well as an estimated $5,700 of health services. These figures are averages: many middle income households consume nothing like this amount, but those with dependent children often consume a lot more. The scope for opting out therefore seems limited, even among middle income households. Lower down the distribution, it is even tighter. Households in the bottom fifth of incomes 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.[11]

How might we enable more people to exercise the sorts of choices that more affluent people are already enjoying?

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?[12]

Later in this paper we shall review ways this might be done. Full entitlement opt-outs (rather than mere contributions opt-outs) are one possibility; rebates on indirect as well as direct tax contributions may be another. But for the moment, it is important to get this problem into proper perspective, for the net tax contributions of many low income households is not as tight as these statistics appear to suggest.

The reason is that 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 a whole lifetime. This means that even the 'poor' enjoy some capacity for opting out of welfare when their lifetime tax payments and welfare receipts are examined. Thus we saw in an earlier paper 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.[13] 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, provided some combination of loans, savings or insurance is available to help them 'smooth out' the peaks and troughs in their lifetime earnings. The opt-out proposals developed below are designed to provide them with this capacity.

We should also remember that 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 while remaining in the state system in another. People might opt out of the government pension, for example, but stay with Medicare. Given this sort of flexibility, even those who pay little tax in the course of their lives should be able to find some benefits that they could afford to trade in for tax reductions if they choose to do so. Under a contributions-based opt-out system such as that proposed here, those on low incomes may not be able to enjoy the same range and extent of choices as more affluent households, but they would still enjoy more choice than they get at the moment.

'Personal future funds' to kick-start self-provisioning

The cornerstone for a new system of opt-outs should be an enhanced system of personal savings. As I have suggested elsewhere, this can be kick-started by denationalising the federal government's 'Future Fund' and redistributing the money to all Australians in the form of 20 million new personal savings accounts.[14]

The Future Fund came into existence in May 2006. 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.[15] 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.[16]

Taking tax from individuals and businesses to build up a government savings fund will depress private investment and may leave future generations worse off

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 has all but been repaid.[17] The Treasury is worried that cutting taxes could stoke inflation, so it prefers to levy taxes that it does not need and to bury the money away in a fund that cannot be touched for another 14 years. But even if the inflation fear is justified, 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. About $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, and new immigrants should be required to establish a fund of their own before taking up residence in Australia.[18] This way, every Australian would have their own future fund, now and into the future. To save on administration costs, these funds could be set up parallel to existing superannuation accounts and could be run by the same financial managers.

Is it right to give away government assets to private citizens in this way? It is certainly justified ethically, for the Future Fund consists of surpluses raised through taxes (which would be returned to those who contributed the money), and Telstra receipts (which would go back to the public who notionally 'owned' the company before it was privatised). This policy is also justified financially, for provided the use of these personal funds is restricted so that the money replaces present or future calls on government benefits or services, claims on government spending in future years could be reduced at least as effectively as anything the government's own Future Fund is likely to achieve.

Using Personal Future Funds for unemployment/sickness savings

One way PFFs could reduce the population's dependence on welfare benefits is by replacing government unemployment and temporary sickness allowances for the first 26 weeks of any claim period. This is an idea similar to that recently developed by the centre-left Hamilton Project in the USA, which has called for the establishment of what it calls 'Temporary Earnings Replacement Accounts'.[19]

Some years ago I proposed a 26 week time limit on eligibility for government unemployment benefits as a way of preventing the drift into long-term unemployment.[20] My idea was that after six months of job search, training and other forms of government assistance, claimants who failed to find work should become eligible to apply for a full-time 'Work for the Dole' (WfD) placement. This would provide a full-time job at basic benefits rates (plus work expenses), and would remain in place until they found alternative employment.

Now, if every Australian had their own PFF, the first six months of unemployment or sickness could be covered out of their own savings without having to apply for government benefits, in which case the existing system of unemployment benefits could simply be shut down.

The initial government transfer of $3,000 into everybody's PFF would 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%. These contributions would have to be compulsory, but they would be offset by an equivalent reduction in the income tax workers have to pay, so they 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.[21] 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, and once they found another job, they would start to replenish their PFF through the 1% income levy. Those who failed to find work during the six month period would be offered a Work for the Dole placement.[22] The existing system of unemployment benefits would therefore no longer be needed and could be wound up.

On an average wage, somebody paying a 1% annual levy into a fund already containing the initial $3,000 of government seed money would take about five years to build up savings adequate to cover six months of unemployment. After that, their fund would continue to grow for as long as they 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, they would now be putting the equivalent amount of money into their own savings accounts. For young people in particular, this could be a very attractive option, for 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 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.

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Using the PFF for Medicare opt-outs

For some people, PFFs would only ever function as a replacement for unemployment and sickness benefits. But for those who wanted to opt out of other welfare state entitlements, PFFs could become an important means of building up tax-free savings that could help them do it.

One area where this might happen is in health care. People could be offered the chance to fund their own routine GP and pharmacy expenses (perhaps up to an annual ceiling), and to insure themselves against medical costs (including hospital treatment) in excess of this amount, in return for which they would pay less tax.

Taxpayers choosing to opt out of the government health care system would obviously be exempted from paying the Medicare Levy, which currently takes 1.5% of their salary, but they would also qualify for further tax reductions on top of this for receipts from the Medicare Levy only cover one-sixth of total government health care costs, with the rest coming out of general taxation.[23] The total value of government health services that people currently consume obviously varies according to factors like their family circumstances and their age, but for most people it would certainly exceed 1.5% of salary. We shall see later that an average tax saving of around $2,500 would probably be required to compensate.

Allowing people to trade their government health care entitlements against tax reductions would reduce tax-welfare churning and enhance self-reliance

People opting out of government health care would be required to buy health insurance and to put a certain amount into their PFF each year to meet routine medical expenses. Any money not used for medical expenses in any one year could be allowed to accumulate in their funds to be used for medical or other approved purposes later on. The build up of savings in their personal funds would enable people to agree to high 'deductibles' on their health insurance (for example, they might agree to meet, say, the first $2,000 of hospital fees from their PFF funds) which would reduce premiums and would help offset any rise in insurance charges following the withdrawal of the Medicare subsidy on hospital treatments for private patients.[24] Health insurers would be required to operate on the 'taxi-cab' principle, accepting all comers, and would not be allowed to discriminate on the basis of personal health histories and profiles.

Allowing people to trade their government health care entitlements 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% without anything like a commensurate improvement in health levels.[25] 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.

One question that would need to be settled is whether, having opted out of Medicare, people would be allowed to opt back in later. It would be better if this were not permitted (due to the obvious problems of adverse selection it would create), but if it were allowed, ways would have to be found of scaling benefits according to the amount of time spent in the government system. The longer people had opted out, the less would then be the incentive to opt back in again.

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

Establishment of PFFs could help reduce tax-welfare churning during people's working lives, but when it comes to retirement, most people already have their own savings accounts. However, the Superannuation Guarantee system in Australia has several important weaknesses that need fixing if it is to replace mass dependency on the age pension when people retire.

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.[26] 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) to qualify for the means-tested age pension.[27] 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.[28]

One way these problems could be eased is by increasing the compulsory contribution to superannuation from 9% to around 15% of salary (with a mandatory 6% employee contribution), and by forcing retirees to convert their lump sums into annuities in order to maximise their income stream and reduce their call on the age pension. Both of these proposals are examples of what I earlier referred to as 'pushing' people out of welfare. Not only would the government force us to save more of our own wages, but we would also be obliged to buy an annuity with our own savings. This would work, but it is an illiberal response to the problems in the current system.

A better alternative might be to coax people away from reliance on the government pension. This could be done by removing the tax on super contributions (and perhaps on super fund earnings too), but only for workers who opt out of the government age pension. Abolishing superannuation taxes would be very expensive in terms of revenue foregone if it were applied to everybody (especially now that the government has removed the tax on final withdrawals) 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 contributions were limited to people willing to give up their entitlement to a government age pension (that is, those willing to opt out), the costings would look a lot better.[29]

An age pension opt-out might work by allowing people to contribute up to, say, 9% of salary tax-free into their super fund in return for contracting out of any future claim on the government age pension

An age pension opt-out might work by allowing people to contribute up to, say, 9% 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.

The problems in the existing system would still remain, of course, for those who did not opt out of the government age pension. In their case, it would be reasonable to require conversion of enough of their super lump sum into an annuity to generate a retirement income comparable to a full age pension (to limit eligibility for the means-tested pension to those who need it). A staged increase in the compulsory contribution of those who do not opt out to 15% of salary (the additional 6% to be paid directly by employees) might also be considered.

By way of illustration...

We can illustrate how the proposals developed in this paper might work out by considering the case of a single person in her twenties with no dependants earning $40,000 pa gross, plus 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 indirect taxes she pays on the goods and services she buys).

Under the changes proposed here and in earlier papers, 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, so her net income is unchanged. 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 six 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. This tax saving must be used to buy health insurance, with the remainder going into her PFF savings. She might therefore buy a catastrophic health insurance policy for $1,500 per annum, putting the remaining $1,000 into her PFF to cover routine health expenditure like GP consultation fees and pharmaceuticals purchases.[30]

With a PFF, a person will depend on government for very little help other than children's health care

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, 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 has children, she will receive tax credits of (say) $4,000 for each of them until they reach school-leaving age. This will either reduce her tax payments by $4,000 per child or will make her eligible for negative income tax transfers, depending on her income. 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 children's health care by default. As she goes through life she will depend on government for very little other help than this.[31]

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.

Getting more inclusive

We saw earlier that people who pay little or no income tax are limited in the degree to which they can cash in their welfare state entitlements in return for tax reductions. A system of opt-outs based on contributions will not hurt them (they stay as they are in the existing welfare state system), but it may not offer them a great deal either. There are two ways that opt-outs might be extended so people on low incomes could take more advantage of them.

Reducing indirect tax payments could make a major contribution to the capacity of low income Australians to make use of welfare state opt-outs

One would be to allow people to cash in the indirect, as well as direct, tax payments they make to the government each year. Even those who pay little or no income tax at any one time still pay significant sums in indirect taxes such as the federal GST and state government duties on petrol, tobacco, alcohol, and the like. If this money could be refunded to those seeking opt-outs, they would be in a much better position to finance their own welfare requirements.

People in the bottom one-fifth of the income distribution receive 21% of total welfare state expenditure (almost exactly their proportionate share), but they contribute much less than their proportionate share of the tax used to pay for it (just 3%).[32] 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. Those in the bottom quintile of incomes in 2001–02 paid almost no income tax (an average of just $132 per annum), but they paid over $3,000 of indirect taxes. Those in the second income quintile, who paid a total of $6,200 in total tax, still contributed two-thirds of this in the form of indirect tax levies. [33]

Reducing indirect tax payments could therefore make a major contribution to the capacity of low income Australians to make use of welfare state opt-outs. But how could this be done? Sceptics like Peter Whiteford argue that, short of abolishing indirect taxes altogether, it can't.[34] But in an age of computer-based networks, with electronic tax returns and electronic funds transfer at point of sale (EFTPOS), it is perfectly feasible technologically to devise ways that people on low incomes could reduce their indirect tax burdens in return for giving up specified welfare state benefits and services.[35] The same technology that enables me to debit my bank account and credit my fly-buys account by swiping a couple of cards at a supermarket checkout could in principle also enable me to have the GST and/or government duties component of my shopping bill simultaneously credited to my personal future fund or superannuation account by the ATO as and when I incur indirect taxes. The issue is not whether it can be done, but whether this would be a good idea. It is worth more detailed consideration.[36]

A second way low income groups could be enabled to participate more fully in opt-outs would be to allow them to cash in, not only their share of the tax/welfare budget that is churned, but also their share that is redistributed to them from other taxpayers. This is the basis of the Hughes/Pearson proposals discussed earlier. It would mean that people who pay in less to the welfare state than they take out would nevertheless be allowed to cash in the full value of their existing entitlements, even though they have not funded them themselves.

To see how this might work we can refer to the detailed proposals put forward for

The federal government's Future Fund should be denationalised and redistributed into Personal Future Funds set up for every adult and child who is an Australian citizen

reforming the New Zealand welfare state by that country's former Labour Treasurer, Sir Roger Douglas.[37] At the heart of Douglas's ambitious reform package is the introduction of a huge, variable tax-free earnings allowance, with tax credits for those earning below the threshold and reduced tax rates for those earning above it.

Douglas's idea is that all the money currently spent by government on health, education and income support should be left in people's pockets (or put into their pockets if they do not earn enough in the first place) so they can buy what they want themselves. Single people with no dependants, for example, would be allowed to earn NZ$32,000 before paying any tax (with a top rate of 33 cents in the dollar). Taxpaying workers would end up saving NZ$6,500 in income tax each year, and those with incomes below NZ$32,000 would receive a tax credit worth the same amount. A married couple with two children would save even more. They end up NZ$21,500 better off, enjoying a tax-free earnings allowance of NZ$76,000 with an equivalent tax credit for those earning below this threshold.

Of course, these households would then have to spend much or all of this money providing services for themselves that are currently provided by government. Their huge tax-free allowances/tax credits would go towards a number of compulsory annual payments including a NZ$4,000 contribution to their own superannuation funds, NZ$1,000 per year on income insurance to cover periods of unemployment, sickness or accident, NZ$1,500 (for a single person) or NZ$4,000 (for a couple with two children) purchasing catastrophic health insurance and everyday health expenditures, and about NZ$4,500 per child purchasing schooling using an education tax credit (or what Douglas calls an 'Opportunity Scholarship').

Douglas's scheme extends effective choice to everyone, poor as well as rich. This is only achieved, however, by giving significant numbers of people large amounts of other people's money in the form of tax credits. This money is, of course, already being redistributed in the existing welfare state system, but Douglas's proposals raise the ethical question of whether it is appropriate to hand over other people's money as a way of enhancing the autonomy of the recipients (as against meeting their basic needs).[38]

A further concern about the Douglas plan is it would *force* everyone out of the welfare state and into the private sector, for all existing state services and benefits are cashed out as tax reductions or tax credits. It therefore does not allow people to choose between staying in the existing system and opting out of it. However, these proposals could be adapted to fit an opt-out scheme by giving everyone a notional welfare state savings account expressing the total value of the services and benefits they use. Those opting out would take this money in tax allowances and credits; those staying in the government system would authorise the state to spend their account on their behalf.

As with the idea for indirect tax credits, the Douglas plan for universal income tax credits (essentially a negative income tax) should be on the agenda in any future discussion of welfare state opt-outs.

Conclusion

Most people pay enough tax over the course of a lifetime to cover most or all of the value of government benefits and services they consume. In theory, therefore, they should be able to keep the money in their pocket, rather than give it to the government, and use it to buy the services they need. The question is how this can be organised in practice.

In addition to raising the Tax Free Threshold (so that people do not begin to pay income tax until they have earned a subsistence income) and reforming the family payments system (so parents with dependent children reduce the tax they pay rather than receiving government hand-outs), three core proposals have been outlined in this paper.

First, the federal government's Future Fund should be denationalised and redistributed into Personal Future Funds set up for every adult and child who is an Australian citizen. Those who are economically active should then be required to build up and maintain these funds through a small annual contribution (compensated by a corresponding income tax reduction) so they can sustain themselves at a basic income for up to six months of unemployment or sickness. The government unemployment benefits system would be wound up, with the long-term jobless offered full-time Work-for-the-Dole placements until they find new employment.

Secondly, those who wished to do so could opt out of the government health care system in return for tax reductions. The money they save in taxes would be used to buy health insurance and to build up medical savings in their PFFs. Any money saved in PFFs that was surplus to the amount needed to cover unemployment and health care commitments could be drawn down on retirement along with superannuation.

Thirdly, those who wished to do so could also opt out of their government age pension entitlement. In return, they could make tax-free contributions (up to an annual limit) into their super funds. Those not wishing to trade-in their age pension would not qualify for these tax concessions and would be required to use part or all of their super fund to purchase an annuity on retirement to minimise their means-tested eligibility for the pension.

Apart from the shift away from government unemployment and sickness insurance (which would affect everybody), nobody would be forced to move out of the welfare state into self-provisioning. The proposals outlined here do not therefore threaten anyone. They simply allow those who prefer to run their own lives and to make their own decisions to do so, rather than having politicians and bureaucrats spend their money for them.

Australians are already voting with their feet. They are abandoning the welfare state in favour of private health care, private schooling, private pensions, private income insurance, not forgetting the longstanding love affair with privately-owned housing. As economic growth continues to raise the general level of affluence and to revolutionise popular expectations and aspirations, ever-increasing numbers of people will seek to spend their own money buying the services they want, rather than relying on the government to give them what it thinks they need.

The proposals outlined in this paper work with the grain of this historical trend by making it possible for more people to exercise real choices and to take more control over key areas of their lives. Nobody would be forced to leave the welfare state if they did not want to, but equally, nobody would be forced to remain either. If allowing people to opt out led eventually to the withering of the welfare state, this would only happen because ordinary Australians had found through experience that they could live their lives better without it.

The withering of the welfare state would only happen because ordinary Australians had found through experience that they could live their lives better without it

Endnotes

[1] I am grateful to Sinclair Davidson, Roger Douglas, Helen Hughes, Stephen Kirchner, Greg Lindsay and Phil Rennie for comments on earlier drafts of this paper. The responsibility remains mine.

[2] Peter Saunders, *The $85 billion tax/welfare churn*, Issue Analysis No 57 (Sydney: The Centre for Independent Studies, April 2005); Peter Saunders, *Six arguments in favour of self-funding*, Issue Analysis No 61 (Sydney: The Centre for Independent Studies, July 2005); and Peter Saunders, *Twenty million future funds*, Issue Analysis No 66 (Sydney: The Centre for Independent Studies, December 2005).

[3] See, for example, Peter Saunders and Barry Maley, 'Tax reform to make work pay' in *Taxploitation: The case for income tax reform*, ed. Peter Saunders (Sydney: The Centre for Independent Studies, 2006).

[4] The private health insurance rebate is usually paid to the insurer so the policy holder pays a reduced premium.

[5] By the 'welfare state' I mean not only cash benefits and transfers, but also government services such as health care, community services, aged care, state rental housing and government schools. This paper focuses only on unemployment and sickness payments, health care and age pensions, but in other CIS publications, Jennifer Buckingham has outlined similar proposals for changes in schooling.

[6] Vern Hughes, 'A cure for health care' *Policy* 20:1 (Autumn 2004), pp 22–27; Noel Pearson, *Welfare Reform and Economic Development for Indigenous Communities*, CIS lecture, Sydney, 25 October 2005.

[7] Andrew Norton, 'Why politicians aren't rushing to increase taxes', in *Taxploitation* ed. Peter Saunders (Sydney: The Centre for Independent Studies, 2006). In May 2003, 57% of voters said they wanted to pay more tax for government health and education spending.

[8] 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.

[9] Saunders, *The $85 billion tax/welfare churn*.

[10] Peter Saunders, *Social Theory and the Urban Question* (2nd edition) (Hutchinson: London, 1986), ch 8.

[11] 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 (Canberra: NATSEM, November 2006).

[12] Sinclair Davidson calculates that the most prosperous quarter of Australian income tax payers contribute 64% of all income tax revenues while the least prosperous quarter pay just 3%: Sinclair Davidson, 'Who's not paying their fair share of income tax?' Table 4.1 in *Taxploitation* ed. Peter Saunders (Sydney: The Centre for Independent Studies, 2006).

[13] Saunders, *The $85 billion tax/welfare churn*.

[14] Saunders, *Twenty Million Future Funds*.

[15] 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.

[16] 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* 22:3 (Spring 2006), pp 28–35; Alan Wood, 'Income tax reform beats parking our money in Costello's future fund', *The Australian*, 9 December 2006.

[17] 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.

[18] 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.

[19] 'Doling up the dole', *The Economist*, 23 September 2006, p 80. On unemployment savings accounts, see Martin Feldstein and Daniel Altman, *Unemployment Insurance Savings Accounts* (Cambridge, Massachusetts: National Bureau of Economic Research, December 1998); Lawrence Brunner and Stephen Colarelli, 'Individual unemployment accounts', *The Independent Review* 8 (2004), pp 569–585.

[20] See Peter Saunders and Kayoko Tsumori, 'How to reduce long term unemployment', *Issue Analysis* No 40 (Sydney: Centre for Independent Studies, September 2003); 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 Australian Bureau of Statistics, *Australian Social Trends 2002: Work, underutilised labour, searching for work* (Canberra: ABS, 2002). Currently, mutual obligation activities kick in after six months, but these do not take claimants off benefits, and after another six 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.

21 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 family payments (or preferably by a new Child Tax Credit to replace existing family payments—see Saunders and Maley, 'Tax reform to make work pay' in *Taxploitation*).

22 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 levy once they found another job. Those who remained unemployed for more than six months would be eligible to apply for a full-time WfD placement where they would earn a subsistence wage. If this were topped up by additional government payments into their PFF, this would ensure they had a positive balance in their fund when eventually they rejoined the labour force.

23 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* (Canberra: ABS, 2006), ch 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 Department of Health and Ageing, *Annual report 2002–2003—Outcome Summary* (Canberra: DHA, 2006).

24 Medicare currently pays 75% of the scheduled fee for patients undergoing treatment in private hospitals. Premiums would therefore be higher, but higher deductibles would moderate this increase. Currently the MBF Health Fund website quotes an annual premium for a new policy taken out by a 50 year old single Australian requiring full hospital cover plus dental, orthodontics, physio, appliances and other extras and with no excess as $1,608 (excluding the 30% government rebate). Offering just $1,000 pa excess brings this down to $1,216—a fall of 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), pp 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).

25 Craig Emerson, *Vital Signs, Vibrant Society* (Sydney: UNSW Press, 2006), p 79.

26 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. Fifty-four per cent 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* (Canberra: Commonwealth Government, 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.

27 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), pp 174–5.

28 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' in '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: Oxford University Press, 2001), p 117.

29 John Humphreys's recent CIS paper suggests scrapping all tax allowances, including the superannuation

tax exemption. But full-rate taxation of super fund earnings under his proposal would reduce the size of people's eventual lump sums since it would eat into the beneficial effects of compound interest over a long period.

30 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.

31 I do not discuss changes to school funding in this paper, but elsewhere Jennifer Buckingham has proposed parents be given education tax credits to buy schooling for their children. Jennifer Buckingham, *Families, Freedom and Education* Policy Monograph No 52 (Sydney: Centre for Independent Studies, 2001) contains an excellent, detailed outline of how education tax credits might work.

32 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 (Canberra: ABS, August 2001).

33 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 (Canberra: NATSEM, November 2006).

34 Peter Whiteford, *The Welfare Expenditure Debate: Economic myths of the left and right revisited*, Paper to SPRC conference, Sydney, 20–22 July 2005, p 19.

35 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; Peter Saunders, 'Brough's welfare plan on right track', *Canberra Times*, 4 December 2006.

36 There appear to be three major objections to the idea. 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. A second objection is that consumers opting out of welfare state entitlements would get tax back in the form of 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. The third concern is the most important—that requiring retailers to separate the tax from the final price they charge, so that the tax can be credited back into the customer's PFF via the tax office computer, would add an unnecessary cost burden in extra administration. This is an issue that would have to be looked at, but given that retailers are already required to act as unpaid tax collectors, it should not make much difference whether the tax is remitted to the ATO or into customers' accounts.

37 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 The Centre for Independent Studies, 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* 19:2 (Winter 2003), pp 21–7.

38 Seen in this way, Douglas's proposal is not that different from Charles Murray's suggestion that everyone be given a basic income by the government which would then close down the welfare system. See Charles Murray, *In Our Hands: A Plan to replace the welfare state* (Washington DC: AEI Press, 2006). The objection to this is the impact a money-for-nothing lifetime government payment is likely to have on the way people start to think and behave. If you offer people money for doing nothing, you will most certainly end up with more people deciding to do just that. Douglas avoids this moral hazard problem to some extent by insisting that those who do not work should draw down their $4,000 annual superannuation contribution before being given any additional assistance.

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