PRIVATE WELFARE

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PRIVATE WELFARE

James Cox

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Foreword

When we speak of 'welfare', we usually have in mind the benefits dispensed by the welfare state. This is a telling measure of the continuing legitimacy of the welfare state and of its resistance to the established trend towards reducing the size and scope of the public sector. Yet a few moments' reflection reveals that we are constantly providing and receiving welfare benefits in our various private capacities: as members of families; as donors to, and volunteer workers for, private charities; and as individuals prudently distributing our incomes over our life-spans. According to the author of this contribution to the CIS Social Welfare Research Program, such 'private welfare' actually looms larger in our lives than government welfare.

This basic point is the first step towards understanding how we can improve the public-private mix so as to enhance the welfare of all. Reducing the 'crowding-out' effect of government welfare on private welfare would bring great material advantages. But James Cox stresses the moral advantages also: an expanded role for private welfare would not only promote a greater sense of personal responsibility but counter the demoralising impact of the high marginal tax rates that the welfare state imposes on private incomes. Nor would such a shift disadvantage the poor: as Cox argues, the government can fulfil its duty to ensure the existence of a welfare safety net without necessarily providing those welfare services itself.

In his classic *The Constitution of Liberty*, F. A. Hayek observes that the welfare state has produced a new kind of institutional expert who 'almost invariably . . . has one distinguishing characteristic: he is unhesitatingly in favour of the institutions on which he is expert'. James Cox is evidently the exception who proves the rule: he has devoted his formidable knowledge and understanding of Australia's welfare state to the cause of reforming it. Yet in doing so, he is really affirming two Australian traditions: the central role of private welfare and the limitation of government welfare to satisfying basic needs. He convincingly shows that these traditions must be reaffirmed and built upon if Australia is to avoid the evils of high taxation and high dependency levels that some other Western countries suffer as a result of allowing government to monopolise welfare.

Michael James

Author's Note

This book represents reflections on my experiences, dating back to the mid-1970s, in advising the governments of the Australian Commonwealth, New South Wales and New Zealand about some aspects of social policy. During that time I have discussed the issues raised in the book with a multitude of people both inside and outside government. Although many of them may disagree with the views that I have arrived at, I am grateful to all of them.

In particular my thanks go to Michael James for suggesting this project and to Greg Lindsay for supporting it. Two referees provided thoughtful comments. Michael James was a sympathetic editor.

The views presented in the book are my own and not necessarily those of the organisations with which I am associated. I, and not my friends, should be blamed for the errors of fact and interpretation that it undoubtedly contains.

James Cox

About the Author

James Cox has held positions in the Reserve Bank of Australia, the Department of the Prime Minister and Cabinet and the Social Welfare Policy Secretariat of the Department of Social Security. He was a principal economist at the Office of EPAC between 1986 and 1989 and has been a consultant to the New South Wales Cabinet Office since 1989. During 1985 he was a Visiting Fellow at Monash University and advised the New Zealand government on aspects of social-policy changes during the early part of 1991.

James Cox has contributed to many government reports and has published articles in Australian economics and public-policy journals. He contributed to the CIS Policy Forums *The Welfare State: Foundations and Alternatives* (1989) and *Restraining Leviathan: Small Government in Practice* (1987).

Executive Summary

1.

Private welfare includes self-provision for future needs through savings and insurance, occupational provision as part of a contract of employment, transfers of income between family members, the private provision of services for the aged and disabled and for children, and donations to charity.

2.

Total private expenditure on social security and welfare is probably much more important than government expenditure on social security and welfare.

3.

Governments should, on moral grounds, ensure the availability of a minimum welfare safety net. Indeed, only governments can do this.

4.

Much income redistribution and provision of welfare services results from private effort. These activities have important advantages in leading to a diversity of services in line with people's interests and circumstances.

5.

Private-sector involvement in the provision of government welfare is often advantageous. This is particularly so with programs that are based on clear objectives, are directed to need, and allow for competitive tendering for the right to produce the service.

6.

Private involvement in the delivery of welfare is being encouraged by the desire of a prosperous and well-educated population for a more diverse range of welfare services and by developments in information processing.

7.

There is a good deal of evidence to suggest that, particularly for groups such as the retired, government welfare tends to 'crowd out' private welfare. Not only does government provision make private welfare less necessary but the taxes required to finance government welfare make it harder for people to provide for themselves and for others.

8.

Government objectives could be achieved more efficiently through the greater use of private effort, by such means as more competition in service delivery, tighter means tests, opting out and the 'brokerage model'.

9.

Greater use of prices (or user charges) to direct resources to their most productive uses in the welfare sector would make it easier to implement these ideas. Distributional objectives could then be met through undirected or earmarked cash payments that could be made either to the beneficiaries of programs or to representatives who could be trusted to act on their behalf.

10.

The preferences of private individuals could play a greater part in determining the size and nature of the welfare program if the tax and social-security treatment of gifts of capital and income were reformed and if the Goodman-Nicholas proposal to allow taxpayers to allocate a proportion of their tax bill to one or more members of a list of approved private charities was adopted.

11.

Australia's institutional arrangements make it unlikely that the welfare state will undergo major changes unless there is widespread agreement about their desirability. Competition and private effort are likely to be used more widely in the achievement of government welfare objectives. Less likely is the rolling back of the state in any fundamental sense.

12.

Australia's traditions of needs-based welfare and private provision of welfare represent a stock of intellectual capital which, if built upon, may enable us to avoid the worst of the dangers that have been pointed to by critics of the welfare state, while continuing to meet the most important of the community's aspirations for economic justice.

Chapter 1

Introduction

This monograph assesses the importance and advantages of private welfare in Australia and New Zealand today, and discusses the prospects for greater reliance on private welfare in the future.

At least some of the objectives of government welfare programs are desirable. Individuals frequently find themselves short of income because they lack skills or opportunities, because they are sick or disabled, because they care for dependants, or because the smooth operation of markets is impaired. All societies have developed ways of addressing these problems; government welfare programs are not the only possible response or even always the best one.

Kinds of Private Welfare

Significant private responses to welfare problems in Australia and similar countries today include:

- savings and the purchase of insurance;
- transfer of income to spouses, children and other family members;
- charity;
- the activities of service clubs and similar organisations;
- mutual assistance (whether informal or through friendly societies and cooperatives);
- the payment by employers, as part of employment contracts, of sick leave, workers compensation premiums, superannuation contributions and so on; and
- the activities of non-government welfare organisations in providing emergency relief and personal social services.

Private welfare may provide individuals with an income, enable them to share in the benefits of an income, or give them assistance in kind through services such as child minding.

To the extent that these private alternatives work satisfactorily, there is that much less need for government welfare. Moreover, a full assessment of the advantages and disadvantages of government welfare must take into account its effects on private welfare.

I argue in Chapter 3 that governments have a responsibility to satisfy the basic needs of those who would not otherwise have been provided for. But it does not follow that governments have to provide the necessary services themselves. It is preferable, on both moral and practical grounds, to meet welfare needs as far as possible through private, voluntary action rather than through compulsion.

Distinguishing Public and Private Welfare

The dividing line between public and private welfare varies. Many activities undertaken by governments in Australia (for example, income support for the aged) are undertaken by family members in some other countries. At one time, the means test for the pension in Australia recognised a responsibility of families to care for aged relatives. More generally, social-security means tests define the boundary between government and private income support. During the first three quarters of the 20th century, the proportion of the population entitled to government income support was increased by the easing of means tests. More recently, governments have tried to increase the role of private welfare. For example: the Hawke Government introduced an assets test for pensions and benefits; family allowances are now paid subject to an income test; and absent parents are being made to support their children through the introduction of a child-support program.

Government Welfare Crowds Out Private Welfare

There is a good deal of evidence to suggest that government welfare tends to 'crowd out' private welfare. The more that governments do for people, the less people need to do for themselves individually or collectively. Moreover, the taxes levied to finance government welfare reduce people's ability to provide privately for their own and others' needs.

Advocates of government welfare have often criticised private welfare on the ground that not everyone has a 'particular other' to provide for their needs. But crowding out may explain why the results of the growth of the welfare state have been so disappointing. At the very least, the effects on private welfare need to be taken into account in considering how much government welfare there should be; and government programs should be designed to minimise their adverse consequences for private welfare. The emphasis should be on helping those who would not otherwise be provided for.

The nature and effects of the crowding out of private welfare by government welfare are discussed in more detail in Chapter 5.

The Significance of Private Welfare

A review of the potential role of private effort in meeting welfare needs is of considerable interest today, for several reasons. First, the size and scope of government has been much discussed in recent years. In Australia, a Labor government points with pride to the reduced share of national output represented by public spending in recent years. In the United Kingdom, New Zealand and other countries privatisation has led to a clear shift in the dividing line between the public and the private sectors.

Markets have been deregulated in several countries to increase competitive pressures on participants, including public enterprises. But welfare-state activities, in contrast, have been subjected to little privatisation and deregulation.

The New Zealand government, however, announced in its Economic and Social Initiative of December 1990 that it was reviewing the extent of the welfare activities that it is prepared to finance. This included consideration of whether the better off should pay for most of the cost of health and some education services which they receive. The New Zealand Budget of July 1991 included the introduction of a means test for national superannuation and a gradual increase in the age of eligibility for it. New user charges were introduced for health care. In future all assistance for housing is to be provided through the social-security system. Housing Corporation mortgages are to be offered for sale and the Corporation's rental operations are to be placed on a commercial basis.

Second, it is increasingly being recognised that government welfare payments are, at the very least, not an easy answer to social problems. Higher welfare spending in Australia over the past 20 years has not reduced poverty mainly because the number of welfare beneficiaries has grown. No doubt this growth has many causes, but some of them may be related to the incentives to enter and remain in welfare dependency. Some commentators argue that private welfare agencies may be better able than government instrumentalities to direct assistance to where it is most needed and to withdraw assistance where it is no longer justified.

A third reason for being interested in the scope for private welfare is the complexity of the objectives of welfare programs. Privatisation (and corporatisation in New Zealand) essentially impose strong incentives on certain organisations to make profits. Other objectives desired by governments must be made consistent with profit maximisation: for example, by financing social objectives explicitly from the budget or by price regulation for natural monopolies. In welfare, service quality is often very important and the users of services may not always be readily able either to judge service quality or to move to a more satisfactory service. The design of contracts between, for example, government and nursing homes, and monitoring the performance of the contracts, are therefore likely to be very complex matters.

Finally, welfare services are a large and growing area of employment. Moreover, a large proportion of the population are direct beneficiaries of government programs or expect to be so. Whether or not one personally supports the growth of private welfare, the likelihood of that growth occurring deserves further investigation.

The chief impediment to greater reliance on private welfare is the adverse effect that such a change would have for organised interest groups, including the providers of state welfare services. The arguments are similar to those concerning the obstacles to the deregulation of certain industries such as telecommunications. We need to assess, on the basis of experience, how we can best weaken or circumvent such opposition. It is worth noting here that while certain goods and services (such as education, health, housing and public transport) are subsidised extensively by Australian governments, there appear to be no general subsidies for food and clothing.

Evaluating Private and Government Welfare

Comparing government welfare and private welfare, and arguing that the latter should be encouraged, involves some conceptual problems. Three possible approaches may be considered. The first is to assess the consequences of alternative policies (for example, on the basis of experience with similar policies in Australia and overseas) and then to evaluate them. But how can such evaluation be made in view of the diversity of individual experience and individual values? I am concerned about the high marginal tax rates that result from high state spending on welfare, not only because of the likely effects on economic activity but also because of the consequences for such matters as honesty, the pursuit of illegal activities, tax avoidance and evasion, and the role of the family in caring for dependants. It is not clear to me, however, how widely these views are shared.

A second approach is to try to develop generally acceptable criteria for judging different situations. One example of this approach is the economist's concept of a 'Pareto improvement'. A Pareto improvement is a change from which at least one person gains and no one loses. This is a fairly restrictive criterion, and few policy changes would meet it. But the potential for a Pareto improvement may exist if a well-focused method of achieving a policy objective replaces one that is less cost-effective. The savings arising from a more cost-effective policy can be used, after compensating those who have been adversely affected, to obtain something else that society values, such as a lower level of taxes or improved welfare services.

At present governments often achieve distributional objectives by providing services at prices below cost. An alternative approach is to price services according to marginal cost but to retain the distributional objective by making cash payments. Such a policy could lead to overall gains to society since people would take marginal cost into account in deciding how much of the service to use.

Because of the restrictiveness of the Pareto criterion, it seems to me that, in practice, economists tend to recommend measures that could be termed 'almost Pareto improvements'. These are measures where the gains far exceed the losses or where the losses are concentrated among seemingly undeserving groups. The ethical implications of a change from which almost everyone gains and a few people lose may be very different from those in which some people gain and no one loses. The distributional implications of policies are important and deserve greater attention.

A third approach is to emphasise processes rather than outcomes. Because everyone agrees to abide by the rules, the outcome of disputes resolution through the legal process may be considered to be fair. But what does this imply for government policies? It is an important democratic principle that governments that are sufficiently unpopular will eventually be removed from office. Even so, many government decisions represent only imperfectly the preferences of the people who elected them; politicians may, for example, be unduly sensitive to the wishes of organised interest groups.

Our constitutional and political institutions render major changes (and especially the withdrawal of the privileges that are enjoyed by special-interest groups) unlikely to occur in Australia without widespread community agreement. The federal system, the upper houses of the Commonwealth and most State parliaments, and the frequent lack of control of upper houses by governments, all tend to limit the power of any one group of ministers and public servants. Reformers understandably complain about how long it takes for their obviously sensible ideas to be implemented. They should take comfort from the fact that, once enacted, their favourite programs are unlikely to be quickly reversed. In contrast, policies are easier to implement and to reverse in unitary states such as the United Kingdom and New Zealand.

Changes that run the gauntlet of the Australian policy process therefore enjoy a high degree of legitimacy. Indeed, it would be useful to regard the arguments advanced in this monograph as suggestions (or, more grandly, hypotheses) that need to be tested in the court of public opinion. I make some comments in Chapter 6 about the kinds of changes that are likely both to increase economic efficiency and to win public acceptance.

Chapter 2

The Importance of Private Welfare

This chapter shows that private welfare is important. First, I examine the historical record, which demonstrates that the relationship between government and private welfare in Australia has always been complex and has changed through time. Next, I review the fairly sketchy statistical data available about private welfare in Australia today. Finally, I review some evidence on the importance of private welfare in Australia relative to some other countries.

Both the historical and the statistical discussions in the chapter are affected by a peculiar difficulty. Historians and statisticians have tended to emphasise the actions of governments and to view the development of non-government welfare through state-coloured spectacles. Within private welfare, the activities of non-government welfare organisations have been more extensively scrutinised than the informal activities of individuals to assist family members, relatives and friends. Some readers of this book will be pleased to learn that there are gaps in the official records. But this does cause difficulties for those of us who would like to celebrate the importance of private welfare in Australia!

Aspects of the History of Public and Private Welfare

The relationship between public and private welfare has been studied by Butlin, Barnard and Pincus (1982) as part of their study of government and capitalism in Australia. In what follows, I summarise their account and offer an interpretation.

During the 30 years following 1860, Australia was one of the richest countries per capita, if not the richest country, in the world. During this halcyon era, it was accepted that welfare should be provided by private effort. Even so, government subsidies were quite important. According to Butlin et al.:

> The basic premises were that care of the needy was essentially a family concern; that those who could, should help themselves lest assistance sap their independent spirits and create a class of dependent poor; and that where assistance was justified, it should be given in kind rather than in cash . . . Private, non-profit charities and religious groups provided a

> range of welfare institutions and services. Indoor relief, consisting at least of a bed for the night and at most of subsistence throughout the remainder of life, was available in institutions catering for the aged and infirm (often in association with hospitals with which they had much in common). Outdoor relief took the form of occasional meals, food, clothing, fuel or vouchers drawn on cooperating storekeepers . . . The charities were subsidised with public funds including, in some cases, statutory transfers of revenue from various categories of fines, etc. Of 218 charitable societies reporting to the Victorian Statistician in 1904, only twelve were entirely independent of the public purse and across Australia in the second half of the 1890s, the institutions providing indoor relief received public aid equivalent to between a quarter and a third of their total expenditure. (1982:157)

In the later 19th century there was concern about the activities of voluntary welfare organisations and particularly those providing institutional accommodation for the disadvantaged. M. A. Jones (1983) notes that

> Between 1873 and 1890 the New South Wales and Victorian governments established five separate inquiries into the operations of the voluntary welfare sector. The first, established in New South Wales . . . inquired into the public charities of the colony and documented the unsatisfactory provision for pauperism. Sydney Infirmary was in a horrifying state and illustrated the problems of allowing hospital facilities to become, by default, agencies assisting the poor. In its second report, the Commission castigated the large charitable institutions for their poor care of pauper children. It recommended a boarding out system, rather than institutionalisation. . .
>
> In 1876 both New South Wales and Victoria established similar boards of inquiry into the Randwick and Kew asylums respectively. . . These inquiries found dreadful examples of incompetence and even sinister activities. . . One result was to increase state control over voluntary agencies dealing with the poor, especially destitute children.
>
> A royal commission in Victoria in 1890 investigated charitable institutions, especially the quality of their management and the problems of government accountability for the substantial funds involved. . . The commission found many problems. The voluntary agencies promoted their own interests, and the

> distribution of subsidies appeared to depend more on political favours than on need. There was some difficulty in accounting for funds, both public and private, and considerable attention was paid to the inefficiency of the agencies' activities. Probably the most comprehensive inquiry into the voluntary sector was the royal commission on public charities established in New South Wales in 1897. . . In its third report, the commission recommended that no further government aid be given to seven out of the fourteen charitable institutions examined. While not as sensational as the Victorian inquiry, the commission found evidence of waste, duplication and general untidiness. (1983:16–18)

Green and Cromwell (1984) show that friendly societies and other mutual self-help organisations were important in meeting the welfare needs of Australian manual workers at the end of the 19th century and the early years of the 20th. According to Green and Cromwell:

> By the 1860s the societies were a major presence in every Australian town. They were known for their organisation of medical services, for organising the supply of medicines, for their sick pay, and for the help they gave to those who fell on hard times. They were known, too, for the social life they offered, often providing the only organised social activities available in the early years of colonisation. . . . They grew rapidly. Before the First World War half or more of the population in Victoria, South Australia and Tasmania were directly benefiting from friendly society services, as were 40 per cent of New South Welshman. And even in the more sparsely populated states of Queensland and Western Australia, between one quarter and a third of the population enjoyed friendly society services. (1984:xiii-xiv)

Manual workers were particularly likely to be members of friendly societies; it was thought that some 80–90 per cent of manual workers in towns were members in the late 19th century (1984:xv).

Membership of friendly societies fell during the depression years of the 1930s. Green and Cromwell estimate that 44 per cent of the Australian population benefited from the activities of friendly societies in 1930, but by 1938 the figure was 29 per cent (1984:14). The expansion of the social security system and the introduction of a national health system during and after World War II thereafter circumscribed the activities of friendly societies.

The depression of the 1890s brought a change in attitudes towards private welfare. The following 50 years witnessed the replacement of several areas of private endeavour by government programs. For example, some State governments and the Commonwealth introduced old-age pensions in the first decade of the 20th century, veteran's benefits were introduced by the Commonwealth after World War I, and during the 1930s there appeared the first government home-ownership programs and State government relief for the unemployed.

A major reason for these changes was the belief that the non-government arrangements were not sufficient to maintain economic justice in the circumstances of the depressions of the 1890s and 1930s and the two world wars. For example, building-society failures during the 1890s wiped out the savings of many and reduced the availability of housing finance. The finances of the friendly societies were also under strain during that decade, and even more so during the 1930s, which reduced their ability to pay benefits to members. By the end of the 1940s, a comprehensive social security system had been developed.

Since 1949 the relationship between governments and private welfare has continued to change: the market has been deliberately used to achieve public ends. According to Butlin et al.:

> Though probably stronger under non-Labor administration, this has been a continuing feature of Australian welfare. Medical and hospital benefits developed as subsidies to those who insured against risks; income tax concessions encouraged this insurance. The activities and incomes of general practitioner and specialist doctors, of private hospitals and nursing homes and, indirectly, of dentists and optometrists were publicly underwritten. So too were the private health insurance funds. Income tax concessions gave a powerful stimulus to private life insurance and superannuation, building societies and private school educators have all been supported by forms of welfare benefit. Tax concessions and benefit supports to individuals, such as those for education expenses and those given as Home Savings Grants, necessarily bolster (and distort) the relevant private market activity. Other measures have been designed to support private non-market operations: subsidies to charitable organisations such as the Red Cross Blood Transfusion Service; tax concessions for gifts to charities (a device of long standing); and certain provisions to encourage accommodation for the aged. (1982:194)

In particular, voluntary welfare organisations are heavily involved in providing services that are directly subsidised by governments.

In the post-war period, then, government welfare has increasingly been provided by non-government organisations. This may be a manifestation of a particularly Australian scepticism: we believe neither that the private sector can achieve economic justice nor that the public sector can achieve efficiency. There are plenty of indications that 'publicly funded but privately supplied' welfare is increasing in importance. The current Commonwealth government, for example, has increasingly turned to superannuation as a way of increasing incomes in retirement.

The next few sections draw together the available information about the importance of private welfare in Australia today. I also try to compare the size of government welfare with that of private welfare activities, bearing in mind that the distinction between government and private programs is not always clear. Because the information is limited, it is not possible to be very precise.

Expenditure by governments (both Commonwealth and State) on social security is around 8 per cent of GDP; total social expenditure (on health, education, housing and welfare) is around 22 per cent of GDP (EPAC, 1987).

Self-Provision

People provide for the future needs of themselves and their dependants when they contribute to superannuation and life-insurance policies, purchase disability and other kinds of insurance, or save in other ways. Savings through home purchase, for example, reduce the need for income in later life.

According to the latest annual national accounts data (ABS, 1989a) savings through life insurance and superannuation were $19.2 billion or 5.7 per cent of GDP in 1988/89. (These figures would, in general, include employer contributions to superannuation.) Savings through superannuation and life insurance have increased rapidly in recent years; in 1978/79, the corresponding figure was 2.1 per cent of GDP. According to the latest ABS survey of superannuation (ABS, 1989b), 51 per cent of employed people in November 1988 were covered by a superannuation scheme. Thirty per cent of people aged 45–74 expected superannuation to be their main source of income following retirement. This compares with 26 per cent for pensions and 12 per cent for other investments.

People provide for their future also through disability insurance and other kinds of insurance. Around $10.6 billion was paid in premiums in 1988 to public and private sector general insurance companies (Insurance and Superannuation Commission, 1989). This figure excludes the premiums paid to health insurers and friendly societies, which are supervised under separate legislation.

According to the national accounts, total saving by the household sector (including unincorporated enterprises) fell as a share of GDP from 8.0 per cent in 1978/79 to 4.1 per cent in 1988/89. This fall may reflect, in part, the unusual economic conditions in Australia during the second half of the 1980s and the many difficulties in defining appropriately, and measuring, saving. Edey and Britten Jones (1990) argue that attention should be paid to gross private saving (which includes corporate saving) and not just household saving. This number has been around 15 per cent of GDP in recent years after allowing for the distorting effects of inflation.

It is not clear that official encouragement of savings through superannuation has led to an increase in total saving; the growth may largely have been at the expense of other forms of private saving (such as home ownership) or government saving. According to Edey and Britten Jones,

> there can be little doubt that concessional treatment of superannuation earnings has led to a shift in the allocation of savings in that direction. What is more difficult to determine is whether or not this has increased saving in aggregate. The answer depends on the extent to which superannuation assets are substitutable for other stores of saving. This question has recently been addressed by Stemp (1988) who cites a number of overseas studies confirming that tax concessions for pension schemes have added to aggregate savings, although by much less than the gross increase in contributions. However, in Australia's case, there has been no obvious tendency for private savings to increase over the past decade, despite the fact that life and super contributions increased as a ratio to GDP by over 4 percentage points. This being the case, and taking into account the cost to public revenue of the superannuation tax concessions (recently estimated by Treasury at about $3 billion), it is possible that the net effect on national saving may actually have been negative, although the counterfactual case is not known. (1990:125)

Occupational Provision

ABS labour statistics indicate that there were 6.1 million full-time employees in Australia in 1988 (ABS, 1989c). Of these, 2.5 million had superannuation benefits as a condition of employment, 4.9

million had employer-provided annual leave, 4.8 million had sick leave and 3.9 million had long-service leave.

Estimates of the amount that the various employer-provided benefits added to labour costs in 1986/87 are available (ABS, 1989d). In that year all employers in Australia paid $7.3 billion for annual leave; for other leave and bonuses, $6.0 billion; for severance, termination and redundancy payments, $2.1 billion; for superannuation, $5.5 billion; and for workers' compensation, $3.1 billion. Total payments were $24 billion, or 9 per cent of GDP (7 per cent excluding superannuation). These fringe benefits, in total, comprised 19 per cent of total labour costs. Some of these payments (such as employer contributions to superannuation funds) are included within the definition of household income (and hence household saving) for national accounts purposes.

Family Transfers

The term 'family transfers' is used here to refer to the sharing between family members of the benefits purchased from one another's incomes. Dependent children and dependent spouses, for example, benefit from the incomes earned by people in employment.

It is hard to know how equally the benefits of incomes are shared within families. Official statisticians have avoided the intrusiveness required to get a definitive or even an approximate answer to this question. Feminists have tended to take a rather dark view about the generosity of male breadwinners towards their dependants. The feminist case against the 'traditional family' has recently been scrutinised elegantly by Tapper (1990).

Ironmonger (1982) has made the most systematic attempt to measure the extent of transfer between family members in Australia. Ironmonger looked at the expenditure of different family types, as reported in the Household Expenditure Survey of 1975/76. From this he estimated the additional expenditures that were made in two-adult as opposed to one-adult households and as children were added to the household. These additional expenditures were assumed to be for the benefit of the additional family members. Once account had been taken of income from property and government, Ironmonger calculated that $12 billion in family transfers would have been required to support the consumption of non-working adults and children. This represented 15.7 per cent of GDP in 1975/76.

The crucial assumption here is that the extra expenditure associated with the presence of additional family members is spent for their benefit. This may not always be the case. The incomes of larger families tend to be greater than those of smaller ones: some of the extra spending may be due to the larger income rather than the consumption needs of the extra family members. But families with children seem to spend less on recreation and entertainment than otherwise similar families without children. The amount of expenditure that benefits children may therefore exceed the amount associated with their presence.

As Becker (1982) has reminded us, this view of the family — that employed members use their earnings in part to purchase goods and services for the benefit of other family members — is incomplete. It may be better to think of these purchases as being combined with other inputs, such as the time spent by family members in activities, like the nurture of children, that are of benefit to family members. Even so, the benefits that families provide for their members are clearly far more valuable than government transfers.

Family members make capital gifts as well as income gifts to one another. According to Dilnot (1990), estimated household wealth in Australia was $533 billion in 1986, of which 60 per cent was (net) housing wealth. Because of the dynamics of asset accumulation and inheritance, much of this wealth is held by the older age groups and may turn over, on average, close to once a generation.

Services

According to Mrs Virginia Chadwick, formerly Minister for Family and Community Services (FACS) in New South Wales (*Sun Herald*, 24 June 1990), around 60 per cent of the FACS budget is spent on subsidies for non-government groups. Proposals to increase the involvement of non-government organisations are assessed on merit.

Adam Graycar and his colleagues (see Milligan et al., 1984, and Graycar & Jamrozik, 1989) estimate that there were around 37 000 NGWOs in 1981 which employed up to 600 000 full-time staff and a larger number of volunteers (Graycar & Jamrozik, 1989:139). These organisations undertook functions ranging from the provision of assistance and services to individuals to acting 'as opponents to the state'. The income of NGWOs in 1981 was between $3 billion and $6 billion, of which 49 per cent came from internal sources (investments, fund raising, donations etc.) and 37 per cent from governments. Almost two thirds of these organisations received some income from Commonwealth, State and local governments.

Services for children. This has been a controversial area recently. It has been suggested that the demand for child-care services could be more conveniently and cheaply met if subsidies were paid directly to individuals and were available for spending in commercial as well as government child-care centres and were not, as at present, paid only to those centres that are part of the government's children's services program.

According to a survey of child-care arrangements in July 1987 (ABS, 1989e), some 51.3 per cent of children used only parental care during the week of the survey. A further 31.7 per cent of children used informal care by relatives and neighbours, but not formal care (pre-schools, child-care centres and family day care). Around 9.1 per cent of children used formal but not informal care and 6.6 per cent of children used both types of care. Episodes of formal child care tend to be longer than those of informal care. Thus around one fifth of episodes of child care of 20 hours a week or more, outside the home, were provided in formal child-care settings.

How important are the government and private sectors in providing formal child care? According to a survey carried out in Queensland (ABS, 1986), a total of 76 380 child-care places were available in 1987. Of these, 47 per cent were provided by government, 32 per cent by non-profit or religious organisations that received government subsidy through the Children's Services Programme, 4 per cent by non-profit or religious organisations that were not receiving government subsidy, and 17 per cent by private organisations that were operating on a 'for profit' basis. The private share of the total had increased from 13.5 per cent in 1982. The Queensland situation may, however, be atypical. Senator Peter Walsh reports (*The Australian Financial Review*, 12 June 1990) that around 80 000 child-care places were available throughout Australia in 1988 through the Children's Services Programme. A survey of commercial long-day child-care centres in November 1988 (ABS, 1989f) found that around 23 000 places of this type were then available, of which 84 per cent were filled.

What about the fees charged by commercial and government-subsidised child-care centres? The average fee charged by a commercial centre for a week of full-day care was $74.06 in November 1988. Two thirds of such centres showed an operating surplus. Comprehensive data on the fees and operating expenses of government-subsidised child-care centres are not available, but a common fee for a week of full-day care in 1990 seems to be around $100. Fee relief is often available. According to Senator Walsh, an assessment in 1988 by the Commonwealth Departments of Finance and Community Services and Health put the average operating cost of a centre that was subsidised by the Children's Services Programme at $175.00

a week or about $200.00 a week if capital cost were added. The Commonwealth government decided to extend fee relief to 'eligible users of approved commercial, employer-sponsored and non-profit non-CSP long day care services' from January 1991.

Services for the aged and disabled. Some services for the aged and the disabled are largely financed privately. An ABS survey of health and welfare establishments in Queensland (ABS, 1989g) showed that 91 per cent of the cost of accommodation services for the aged and 67 per cent of the cost of hostels were financed from patients' fees. Other services, requiring a greater degree of medical involvement, were financed mainly by public money.

A survey of disabled and aged people in 1988 (ABS, 1989h) identifies the providers of help to those who need it. The most important source of help was informal help from relatives, friends and neighbours. For example, of the 388 000 disabled people who received assistance for home maintenance, 350 000 received it mainly from informal sources. Where formal help was provided, privately arranged or commercially provided services were important for home help, home maintenance and transport. Government-subsidised services were important for home help, home nursing and Meals on Wheels.

Some 322 000 people were carers of the handicapped at home in 1988 (ABS, 1990). These are persons over the age of 15 years who live with a severely disabled person and who were considered by that person to be the most important helper.

Voluntary work. So far we have examined how welfare provision is divided between government services, government-subsidised services and private services. Another indicator of the importance of the non-government welfare sector is the amount of labour that is provided to it. A survey in New South Wales in October 1986 (ABS, 1987) showed that 27.5 per cent of the population aged 15 years and over undertook some kind of voluntary work during the year ended October 1986. Over half of these people provided help for at least 80 hours (the equivalent of more than two weeks of full-time employment).

A Time Use Pilot Survey was undertaken in Sydney in May and June 1987 (ABS, 1988). The survey found that people spent 32 minutes a day on average in child care and 16 minutes a day on volunteer and community work and religious activities. This compares with the average of 181 minutes a day spent in paid work. For women aged 25 to 44, the corresponding figures are 90 minutes (child care), 15 minutes (voluntary work) and 151 minutes (paid work). As the ABS recognises, these figures probably understate the amount of time spend on child care and caring for the aged and disabled, as these activities are often carried out in conjunction with others (like preparing and eating meals).

Housing

Recent assessments of housing policy (for example Gruen, 1988) have drawn attention to the tenure-specific nature of housing assistance: the amount of government subsidy that a person or family receives depends on the kind of housing they inhabit. On the whole, home owners are the most generously treated, through the exemption of imputed rent (net of outlays on repairs, rates, mortgage interest etc.) in assessing taxable income, and the exemption of owner-occupied housing from the capital gains tax, land tax in some States, pensions assets test and so on. Note, however, that much of this assistance may be capitalised into increased prices for housing and may be of little value to new (as opposed to existing) home buyers. Tenants in government housing benefit from the low rents they are charged; rents are rebated so as not to exceed a certain percentage of income (generally 20 per cent of income in New South Wales). The cost of rent rebates in New South Wales (the extent to which the rents actually charged are below market rents) is estimated at around $500 million in 1989/90 (NSW Department of Housing, 1991). The low rents charged in public housing have resulted in a long waiting list for this type of accommodation. In contrast, private tenants are the least generously treated by government housing policies.

Over the last ten years or so public housing subsidies have become increasingly well-targeted. To a greater extent than before, those in public housing have low incomes. Even so, public tenants are only a fairly small proportion of the low-income population.

Some evidence is presented in Table 1. This table has been extracted from Appendix A in Gruen (1988) and is based on the ABS 1986 Income and Housing Survey. It shows that only about one in eight of the lowest income group is a government tenant and more than twice as many of those with low incomes rent private as opposed to government accommodation. These figures may well understate the contribution of the private sector in housing the low-income population because they exclude those who are renting, boarding or lodging with relatives, those who live rent-free, and visitors.

Table 1
Income and housing costs 1986
All income units

Weekly income range	Owners (%)	Buyers (%)	Rent private (%)	Rent govt (%)	Total (%)
Less than $150.00	8.69	1.42	4.41	1.99	16.51
Less than $250.00	18.25	4.09	8.12	3.64	34.10
Total	38.05	31.60	24.96	5.39	100.00

Note: Entries add across rows

Source: ABS 1986 Income Survey, as quoted in Gruen, 1988: Table A10.

Donations to charities

A survey undertaken by A. G. B. McNair for O'Keefe, Panas and Partners estimated that Australians donate around $869 million annually to social welfare, religious and similar organisations (O'Keefe, Panas & Partners, 1989). This amounted to about 0.25 per cent of GDP in 1988/89. The estimate excludes corporate gifts and sponsorships, bequests and in-kind services.

Charitable organisations also receive significant tax concessions from Australian governments. Figures suggest that around $200 million in deductions for charities was claimed in income tax returns in 1987/88 (Australian Taxation Office, 1989). Many charities are not subject to federal and State indirect taxation. For example, New South Wales granted tax concessions worth $26 million for welfare purposes in 1988/89.

Summary

The relative importance of government and private effort in a number of areas is summarised in Table 2 below. Government welfare includes those services which are provided or subsidised by governments.

This Table is, so far as I know, the best that can be done with the available information, but problems with the information reduce its usefulness. There is some uncertainty about precisely what should be included in self-provision. As pointed out earlier, the estimate of the size of the family transfers is highly conjectural. Occupational welfare arguably is not welfare at all but simply forms part of remuneration as wages under another name. (Superannuation contributions by employers have been counted here as part of private welfare.)

Figures for the institutional care of the aged and the disabled have not been presented here; the policy of all Australian governments is to

Table 2
Sources of welfare, 1988/89

	Government welfare	Occupational welfare	Private welfare
Income support (% of GDP)	7	7	15 (self provision) 16 (family transfers)
Services for children (% of total – sum to 100%)	7 (govt only) 5 (mixed)		83 (informal) 2 (formal) 2 (mixed)
Services for aged and disabled at home (% of total – sum to 100%)	5		81 (informal) 14 (formal)
Housing (low income) (% of total – sum to 100%)	12		88

Source : See earlier discussion

minimise the numbers receiving this (very expensive) form of care. The data shown here for services for the aged and disabled relate to home maintenance, since this is the activity for which help is received most often. The use of formal help is less important for activities such as self-care, mobility, meals or transport. Home help is the activity most often provided or subsidised by governments: the proportions are 11 per cent (government formal); 6 per cent (private formal); and 83 per cent (informal).

I hope that others will feel encouraged to bring forward revised versions of Table 2. Despite the difficulties, the information in the Table should be sufficient to demonstrate that private welfare is more important, and probably much more important, than government welfare. Government policy needs to be developed in the light of this revised understanding.

Comparisons with Other Countries

In view of the difficulty in getting information about the importance of private welfare in one country, it is not surprising that few attempts at cross-national comparisons of the importance of private welfare have been made. One such attempt has been made by Martin Rein.

Rein proposes a splendidly encompassing definition of the welfare society (as opposed to the welfare state): 'We need to think of the welfare society in a more precise way, namely as the structure of rules and institutions where the state and the market interact as instruments for protecting the members of society against the uncertainties of industrial society' (1981:36). This definition would, I think, include those things that people do for themselves and for others as well as the things that they are required to do by government or as a condition of employment. But Rein concentrates mainly on the role of government in mandating, stimulating, supporting and regulating private enterprise to achieve welfare objectives. Moreover, privatisation 'can be a useful concept if it is understood to include the active role of the state in the use of the private sector to achieve the ends of public policy. In this context, privatisation refers to the use of private institutions for the realisation of public ends' (1981:12).

Rein's empirical work focuses on the role of fringe benefits for employees, comparing their importance in a number of European and North American countries in the early to mid–1970s. He concludes: 'first, fringe benefits as a percentage of labour costs are impressively high and rising. Secondly, when these fringes are added to the transfer payments we conventionally identify as welfare state expenditure, the range of outlay among countries is noticeably narrower' (1981:23). The data for Australia in 1986/87 that were quoted earlier suggest that Australia is one of the countries in which fringe benefits are relatively unimportant. Problems of comparability arise and recent developments, such as the growth of superannuation, may have increased the importance of fringe benefits.

Further evidence about the importance of public and private welfare overseas has come from the Luxembourg Income Study. This is an ambitious attempt to develop, on the basis of household surveys, comparable data on the economic status of various groups in different countries. At least in principle the Luxembourg Income Study might give us answers to such questions as whether poverty in Australia would be reduced if we adopted Swedish social-security arrangements. The value of the answer would depend largely on the extent to which the behavioural adaptations to the incentives that different social policies generate can be taken into account.

Data from the Luxembourg Income Study indicate that retirement income from earnings and investments is unimportant in countries such as Germany and Sweden, which have extensive social-security arrangements. Income from earnings and investment tends to be more important in countries such as the United States, Canada and the United Kingdom, where public pensions are less generous (OECD, 1988; Smeeding et al., 1990). This suggests that government welfare in retirement 'crowds out' private welfare. (The issue of crowding out is discussed in Chapter 5.)

Many OECD countries are concerned about the financial commitments that result from their pension arrangements. The slow growth rates of recent years have imposed financial constraints, which may well tighten over the longer term as the population ages. According to the OECD (1988:11): 'No OECD country is at present contemplating or undertaking a radical reform of their existing public retirement arrangements involving drastic reductions in benefits and eligibility. The main reason for this reluctance lies in the difficulty of reaching a consensus and thus of gaining the necessary political backing.'

Nevertheless, present arrangements do permit marginal changes that would make pension arrangements in foreign countries more like those of Australia. 'The tendency to strengthen the social aspect of public pension schemes is expressed in measures which concentrate the available resources on the very needy. This is sometimes accompanied by the reduction or abolition of earnings-related features but is mostly reflected in a closer scrutiny of needs, benefits, income or assets of pensioners' (1988:12). Social insurance arrangements have been placed on a more nearly actuarial basis, for example by placing greater emphasis on the replacement of lifetime earnings rather than earnings in the last few years of work.

The OECD study adds that there is increasing interest in most countries in private-sector provision such as occupational or personal retirement arrangements. 'Currently, in most countries, public provisions are by far the most dominant form of income support for the elderly, leaving little scope for other arrangements which might perhaps be better adapted to meet individual preferences as well as economic requirements' (1988:12). Moreover,

> To compensate for future reductions in the generosity of public pensions schemes there is a general tendency in all OECD countries to rely increasingly on support from the private sector. The private sector is historically important in countries where earnings-related pensions are low or restricted by ceilings, and where coverage is not universal for all those who are employed. However, this trend is now widespread, and includes countries where private provision has been paramount. (1988:104)

New Zealand is one country that is now considering radical changes to its pension arrangements. As already noted, the 1991 Budget announced a means test for national superannuation and an increase in the age of eligibility. In October 1991 a Task Force on Private Provision for Retirement was established to report on policy options to encourage greater self-reliance of retired people. The Task Force has been commissioned to report on matters such as compulsory contributions to, and the tax treatment of, private superannuation schemes.

Conclusion

This chapter has shown that in Australia many welfare services are provided through private effort. Some of this effort is subsidised or regulated by governments. In some areas (e.g. care of the aged and children and provision for retirement) government-subsidised and regulated effort may be expanding at the expense of purely private effort. This situation reflects mistrust by the public of both market and government. The public sees a role for both government and the market (or voluntary effort more generally) in providing welfare: government effort by itself cannot be trusted to be efficient nor private effort equitable.

It should not be thought that 'privately provided but government-regulated or subsidised welfare' is necessarily the best available way of organising welfare services. Indeed, it may have important disadvantages, such as diverting voluntary and community effort unduly towards lobbying for government subsidies. The interest groups that organise around subsidies are likely to form a vocal lobby for their continuation and extension.

The observation that Australians are suspicious of both markets and governments has been made before. In the published version of his Boyer lectures, John Passmore (1981) wrote as follows:

> So far I have been developing my original claim: that in Australia we mistrust governments. Then how are we to account for the proliferation of our government enterprises. In the US, after all, there is no government broadcasting, there are no government trading banks, no government air lines, to take only the more obvious instances. Well, if we mistrust governments, we also mistrust private enterprise. Many of us read with sympathy Adam Smith's remark that 'people of the same trade seldom meet together but the conversation ends in a conspiracy against the public'. That is the other side of our fondness for an arrangement by which government enterprises compete with private enterprises. It is a way of mistrusting private enterprise and government simultaneously. One must add, as illustrating our mistrust of private enterprise, the sufficiently obvious point that it is in any case restricted by a

> formidable array of legislative and administrative rules, designed to protect the worker, the consumer, the environment or some more vaguely conceived national interest. (1981:52–3)

There is an important lesson here. The public seems to have been learned over the past ten years or so that its fears about freely-competitive enterprises were exaggerated. Many people now accept that there is little to be gained by having public enterprises compete with privately-owned firms in regulated markets. Moreover, many of the problems that the public associates with private enterprises (such as excessively high prices or insufficient or poor-quality services) may well be the consequences of government attempts to limit competition in the relevant markets (such as by restricting entry) or to regulate the behaviour of firms or to provide subsidies. People of the same trade are particularly likely to meet together if they expect that by so doing they may encourage the government to grant them greater privileges.

Just as Australians' mistrust of competitive markets may have been misplaced, so may be their mistrust of voluntary (or indeed government) efforts to achieve welfare ends. The next chapter assesses the extent to which this is so.

Chapter 3

The Scope and Limits of Government's Welfare Responsibilities

The most important issues concerning the welfare state are moral ones. The welfare state may well reduce the wealth of the community and curtail certain personal freedoms. But to many people this is a price worth paying to reduce material deprivation. The growth of the welfare state in recent years has, to a considerable extent, been a consequence of interest-group politics (see Chapter 7 for further discussion). But this growth has derived much of its legitimacy from the general belief that it was justified in terms of economic justice.

Since other publications in the CIS Social Welfare Research Program (especially James, 1989) have discussed the moral issues concerning the welfare state in some detail, I can be fairly selective here. Much of the discussion centres on moral arguments for the welfare state canvassed in two recent books by Robert Goodin (1985, 1988). As Robert Goodin (1985:151) puts it: 'ordinarily the State is (and morally ought to be) the agent of last resort for purposes of promoting a person's welfare. The welfare state discharges residual, secondary, backup responsibilities'. I endorse Goodin's argument that a residual welfare state, like the provision of a legal system, is an inescapable moral responsibility of governments in market economies. However, it does not follow that governments have to provide such welfare services themselves, since at least some such services can be supplied privately.

Goodin suggests, but does not argue, that his argument may support the provision of welfare beyond this minimum level. But it is not obvious that it does. Goodin generally underestimates the adverse consequences of the welfare state (and the taxes that are used to finance it) on the behaviour of beneficiaries and taxpayers.

Finally, Goodin argues that, in order to prevent the exploitation of the 'abjectly dependent' by those on whom they depend, welfare should take the form of entitlements governed by legally-codified rules: those dispensing the benefits should have minimum discretion to withhold or lay down conditions for the receipt of benefit. Substantial government involvement in the delivery of basic welfare would therefore be required; non-government organisations could be involved only as the government's agents in providing services and paying benefits according to the agreed rules. However, in my opinion Goodin overstates the extent to which programs such as those administered by the Australian Department of Social Security avoid discretion and exploitation.

Need, Equality and Community

Traditional arguments for the welfare state have been made in terms of need, equality and community (Goodin, 1988) or equity, solidarity and community (Saunders, 1987). As Goodin notes, there are difficulties in using these arguments to provide a moral basis for the welfare state. It is clear that much welfare state activity is about alleviating need and there are instances where need is clear and pressing. But it is hard to know where need ends and mere want or desire begins. Many have argued, for example, that people need at least to achieve the minimum standards of decency that are required by the community in which they live. According to Adam Smith (1776, 1976:870), 'basic necessities' include those things that 'the custom of the country renders it indecent for creditable people, even of the lowest order, to be without.' These 'basic necessities' presumably increase with the average standard of living of the community which gives rise to them.

These arguments about need are closely related to the debate about poverty lines (see SWPS, 1981). We all know extreme poverty when we see it. But it is far from easy to draw a line that divides the incomes of the poor from those of the non-poor. The amount of income a family needs to live decently varies greatly with such factors as ownership of assets (such as housing), skills and competencies, and the amount of assistance received from relatives, friends and neighbours.

The argument that the welfare state is intended to achieve equality or equity is unsatisfactory. The objective of the welfare state is the much more modest one of limiting the domain of inequality by ensuring that people are provided with at least a minimum level of welfare.

Equally unsatisfactory is the argument that the welfare state is intended to achieve (or perhaps to express) community or solidarity. The essence of community, surely, is that a small group cooperates to provide services or mutual assistance. In contrast, the typical welfare state activities of receiving benefits or paying taxes are highly impersonal. If communities worked as communitarians wished them to, the welfare state would be unnecessary.

Vulnerability

Given the limitations of the usual arguments, how can the moral foundations of the welfare state be secured? Goodin argues that we have a particular responsibility to take into account the interests of those who are strongly affected by our actions and choices. 'Interests' here are not only material ones but also ties of emotion such as love and friendship. Goodin considers that the responsibilities that we are commonly thought to owe to business partners and colleagues, those to whom we have made promises and to family and friends stem at least in part from their vulnerability to our actions and choices. These are responsibilities that we owe to 'particular others'. But we may have a more general duty to protect all those who are vulnerable to our interests and choices. Moreover, we have a responsibility collectively to protect the interests of others who are affected by the interests and choices of groups of which we are members.

It is from this vulnerability that the moral case for the welfare state arises. The moral community as a whole is responsible for ensuring that the basic needs of its members are met. Wherever possible, this should be done by matching vulnerable individuals with particular others. But the state has a responsibility to step in when those with primary responsibility are unable or unwilling to help. Government assistance is sometimes unavoidable but always second best: 'though sustenance is provided, love, empathy and companionship are not' (Bane, 1983:100). The state's responsibilities arise from its powers of compulsion. The state is usually the agency best able to discharge society's objective of providing assistance of last resort.

Disadvantages of the Non-Residual Welfare State

However, while we have a duty to help the abjectly dependent, it is far from clear to me where this duty ends. The biblical injunction that 'thou shalt love thy neighbour as thyself' certainly does not imply complete equality. One has to deal with people as they are. The disincentive effects of a situation of complete equality — if such a thing could be engineered — are likely to result in a lower standard of living for everyone, including the most disadvantaged. Rawls (1971) argues that we should favour inequality to the extent that it improves the standard of living of the poorest person. A greater degree of inequality would be favoured to the extent that we take account of the welfare of people other than the most disadvantaged in the evaluation of alternative social arrangements.

As the scope of the welfare state moves beyond providing for the basic needs of its members, so the moral priority of welfare state expenditure over other kinds of spending becomes weaker. Of course, governments may choose to make such expenditures. But, as the welfare state expands, the increasingly adverse effects of social benefits and taxes on the behaviour of beneficiaries and taxpayers must be weighed against their contribution to achieving social objectives.

Goodin and those who agree with him underestimate the adverse consequences, including the adverse moral consequences, of the welfare state. They are therefore less concerned about, for example, the tendency for welfare benefits to be extended to the middle class than I would be. Goodin discusses the effect of taxation on the behaviour of taxpayers only briefly (1988:231–2), and even then deals only with its effect on the amount of work effort. He then concludes that virtually no disincentive effects for the non-poor arise out of income tax. Goodin discusses in more detail the effect of benefits on the work and savings behaviour of beneficiaries (1988:233–5). He cites estimates by Danziger, Haveman and Plotnick (1981) to the effect that transfer programs reduce the work hours of recipients by 4.8 per cent of total work hours of all workers in the United States. Savings are estimated to be reduced by somewhere between zero and 20 per cent of their value without the programs. Goodin concludes that the benefits of the welfare state are great and the costs low.

The effects of taxes and transfers on behaviour are complex and hard to determine. A large amount of imaginative empirical research has not produced any clear results. The conventional wisdom about the effects of taxes on hours of work is well summarised by Saunders and Klau (1985:164): 'empirical evidence on the relative strengths of the income and substitution effects is not conclusive enough at the present juncture to draw strong policy implications'. There seems to be some agreement that transfers reduce hours of work but little agreement as to whether taxes and transfers reduce saving.

It is understandable, therefore, that someone who is worried about poverty may well believe that transfers have little effect on behaviour. Someone who is more concerned about increasing Australia's economic growth rate may well believe that the effects are serious. I myself am convinced that the conventional view understates the adverse effects of social expenditure and taxes on behaviour and economic welfare, for three reasons. First, the effect of taxes on hours of work and saving is only part of the story. A complete analysis would take into account the effect on training, labour productivity, retirement decisions, the choice of saving and investment options, decisions to avoid and evade tax and much else besides. Second, taxes can lead to a reduction in welfare even if behaviour is unchanged. Suppose the government decides to increase taxes. A worker may then feel that, other things (including income) being equal, he or she would prefer to reduce hours of work and spend the time with his or her children (the 'substitution effect'). But on further reflection the worker may decide that he or she cannot afford to reduce his or her hours of work (the 'income effect'). Even though behaviour is unchanged, there is a loss of economic welfare because the new post-tax wage rate is inadequate compensation for giving up family time. Third, people may do less individually to promote the welfare of themselves or others if governments expand public welfare programs. This 'crowding out' argument is a further hole in Okun's (1975) leaky bucket: another reason why the net effect of welfare programs on economic well being may be quite small.

The Effects of Taxes on Welfare

The first two of these arguments are worth exploring in more detail here. The third argument is discussed further in Chapter 5.

The first issue is really one of perspective. Since beneficiaries are only a small proportion of the population, it is perhaps not surprising that benefits result in only a small reduction in work effort. But the reduction in the **beneficiaries'** work effort may be large.

Marginal effects may be more important than total effects. For example, a small increase in taxes may give rise to economic costs that are large in relation to the amount of revenue that is raised. Equally, an increase in benefits may give rise to costs that are large in relation to the reduction of poverty that is achieved.

Economists often think in terms of the excess burden of taxation: the loss in economic welfare that is associated with taxation. Attention has recently been focused on the marginal excess burden of an increase or decrease in taxation as opposed to the total excess burden. The last slice of revenue may be disproportionately expensive in terms of revenue raised. Estimates for the United States, for example, by Ballard et al. (1985) suggest that the efficiency cost of every additional dollar of tax revenue is a reduction in economic welfare of around 15 cents to 100 cents or more. For Sweden, Hansson and Stuart (1985) suggest that, for a 70 per cent marginal tax rate on labour income, excess burden per dollar of revenue can vary between 69 per cent and

129 per cent depending on the uses of tax revenue. Findlay and Jones (1982) have reported results for Australia that are similar to those for the United States: their preferred estimate is 40 cents.

Some recent studies (for example, Hausman, 1981) suggest that labour supply responses to taxation are stronger than was previously thought. That of some groups (for example, married women) is thought to be particularly sensitive, since women often have a productive alternative use of time in child care.

Although Burtless and Haveman (1987:49) have argued that 'some of the new estimates [of marginal excess burden] are overdrawn and highly uncertain', they accept that taxes have adverse effects on economic efficiency.

Public and private-sector administration and compliance costs have been excluded from these estimates. Slemrod and Sorum (1984) estimated that in the United States individual compliance costs alone were 5 to 7 per cent of total federal and state income tax revenue. Australian estimates by Pope and Fayle (1990) suggest that the cost to taxpayers of complying with personal income tax is between 7.9 and 10.8 per cent of tax revenue. This high (by international standards) figure reflects the frequent use of tax advisers by taxpayers and the high value that they place on the time spent in complying with income-tax legislation.

The late Secretary to the Commonwealth Treasury expressed his concern that much high-cost effort is put into 'arrangements for [minimising] tax, rather than commercial reasons. Such effort is a deadweight loss to the community, as well as a potential threat to the equity of the tax system. For this reason the process of tax reform must continue to have as one of its chief objectives the diminution of tax considerations in financing and investment decisions' (Higgins, 1990:13).

Much attention has been paid to the effect of taxes on labour supply, and particularly hours of work, and to the effect of taxes on savings. But, particularly in the longer term, there is a wider range of effects that needs to be taken into account. As has recently been argued by Assar Lindbeck (1986) and others, an increase in taxation (for example, to finance redistributive transfers) can give rise to many disincentive effects. First of all, taxes can affect labour supply. This, however, has many aspects, including hours of work, intensity of work effort, whether to 'do it yourself' or engage outside assistance, the number of earners in a family, non-monetary benefits, choice of occupation, investment in education or training, labour productivity, retirement and immigration. Second, taxes (and the transfers they finance) may affect the propensities to save, the movement of capital across national borders and asset acquisition and disinvestment. Third, taxes may have wider social effects, such as on the role of the family in caring for dependants, tax avoidance and evasion, honesty and the pursuit of illegal activities. Fourth, responses to taxation may take indirect routes: for example, employee pressure through trade unions for higher wages or a shorter working week.

Because of the multiplicity of the margins of choice that are distorted by taxation, the combined effect may be much greater than a study of one or two aspects would reveal.

The effect of high marginal tax rates in discouraging honesty and in encouraging tax evasion and illegal activities is particularly to be deplored on both moral and efficiency grounds. Peter Jonson (1990) has argued that inflation has led to a decline in moral standards in much private, business and government behaviour. Surely high tax rates have also had a large part to play here. Of course people should not behave like this and perhaps, as Robert Frank (1988) has suggested, if they had a sufficiently clear view of their long-term interests they would not do so. But we have to deal with people as they are. The effect of high taxes on standards of honesty and behaviour, in my view, constitutes a very real constraint on the extent to which the welfare state should be expanded. Of course, the injudicious nature of our tax system does not help; some uses of time and of funds are taxed heavily and others are taxed much less so. The government first creates temptation and then punishes those who yield to it. The very necessary measures which have been taken against fraudulent use of benefits in recent years are eloquent testimony to the temptations resulting from our welfare system.

Vulnerability, Discretion and Rules-Based Welfare

The creation of vulnerability is often desirable. We are vulnerable to the actions of those whom we love, or to whom we are bound by ties of affection: only by living independently of such ties could we avoid vulnerability. As Becker (1982) has noted, it may well be sensible for one adult family member to concentrate on earning an income in the market while the other concentrates on caring for children, at least for a while. Such a division of labour, although efficient, increases the vulnerability of the non-earning spouse to the actions of his or her partner. These arrangements are only likely to be entered into if there is a sufficient degree of trust between the partners.

Goodin argues, however, that the exploitation of vulnerabilities should be avoided wherever possible. To this end, no one should have exclusive discretionary control over the resources that another needs to protect his or her vital interests. The needy should be assisted through rule-based systems in which those dispensing the benefits should have minimal discretion to withhold benefits from those entitled to them, or to lay down conditions for the receipt of benefits. Goodin quotes J. S. Mill (1848,1970:335–6): 'The state must act by general rules. It cannot undertake to discriminate between the deserving and the undeserving indigent. It owes no more than subsistence to the first, and it can give no less to the last . . . Private charity can make these distinctions; and in bestowing its own money, is entitled to do so according to its own judgment.' The only role open for private welfare in this scheme of things is to act as the government's agent in making payments or delivering services according to the agreed rules.

In my opinion, Goodin overstates the difference between private and government welfare: private welfare is less exploitive than Goodin suggests and government welfare more so. A number of points should be made here.

First, although individuals can decide how best to spend their money, larger organisations such as charities are likely to develop standard rules of procedure to help them to deal with a large number of cases. These rules will tend to limit capricious decision-making by particular staff members. More important, perhaps, those who are refused assistance by one source may well be helped by the next one. Thus, the consequences of a refusal to help may be less than they appear to be at first sight and the danger of exploitation correspondingly less.

Second, the improved administrative procedures associated with the 'new administrative law' have, since the late 1970s, made government departments more accountable to the beneficiaries of their programs. But, as Ratnapala notes (1990:93), the Administrative Appeals Tribunal rarely questions basic policy. Social-security policies have varied over the past decade according to what appears to be electorally advantageous by governments. For example, differing meanings have been given in practice to the requirement in the Social Security Act that the unemployed should be looking for work or that invalid pensioners should be incapacitated for work to the extent of at least 85 per cent. This instability in basic policy detracts from the value of the guarantees that are offered by the welfare state and makes it harder for people to plan for the future. It is now common for members of the 'baby boom' generation born in the late 1940s and early 1950s to question whether the age pension will still be available when they reach retirement. Such uncertainty is particularly serious for the poor. To overcome this and other problems, Ratnapala suggests that a consensus on basic welfare should be entrenched in the Constitution (1990:101–2). This would presumably occur after public discussion not only about the basic rights themselves but also about the costs of providing them.

Third, although individual officers of the Department of Social Security, for example, may not have much freedom to set conditions for the receipt of benefits, the government as a whole certainly does. In reality, government assistance does not flow equally to the deserving and the undeserving. Society tries, for example, to prevent those who are able but choose not to work from receiving benefits. In recent years greater emphasis has been placed on requiring beneficiaries to observe social norms: for example, it is increasingly expected that those who are able to should work, train or study. There is a good reason for this: recent experience has shown that the number of unemployment beneficiaries increases if eligibility requirements for receipt of the unemployment benefit are relaxed. But it may be just as exploitive to require beneficiaries from government programs to undergo training courses that they consider to be of little value as it is for them to meet the requirements of private welfare organisations. Of course, training courses may well be in the beneficiaries' long-term interests, but so may be the advice and instruction of private welfare organisations.

Finally, Goodin argues that the problems with discretion arise from the effort needed to ensure that assistance goes to all those who need it and only to those who need it. Because of the great variation in individual circumstances, a good deal of discretion is required. To minimise the extent of discretion, Goodin proposes that a rule of generosity should be adopted: officials would be required to ensure that everyone who needs help receives it, but should be less concerned to ensure that those who do not need help should be prevented from receiving it. Goodin is able to propose this rule partly because, as discussed earlier, he believes that the efficiency costs of taxation are not very high. If he were right, there would be no reason to be concerned, for example, about the growing numbers of middle-class beneficiaries from state welfare so long as the poor also qualified. Nor would there be any reason to worry about the tendency of government agencies to deliver services at more than the minimum cost.

For the reasons presented earlier it is, however, necessary to weigh the efficiency costs of taxes against the social benefits of the tax-financed welfare spending. This limit to finance has resulted in a number of consequences for social programs. Where universal (non-means-tested) benefits have been paid in Australia, they have tended to be inadequate to meet the needs of the poorest. The almost universal family allowance has therefore been supplemented for low-income families by the family allowance supplement. Pensions and benefits (which are means-tested though not always stringently) are supplemented by emergency relief provisions for the poorest which are administered by non-government welfare organisations. An equally serious problem can arise where the government provides welfare services. These services are often priced below cost for social-policy reasons. Because of budget constraints, it is not possible to provide the subsidised service for everyone who would like to use it, giving rise to inequalities of access. Moreover, there is a tendency for governments to provide services to the better-organised and most vocal groups, rather than to the poorest groups. Were it possible to reduce the cost of the service (e.g. through the introduction of competition), progress could be made towards reducing inequalities of access.

Chapter 4

The Strengths and Weaknesses of Private and Government Welfare

By private welfare I refer to those payments that are made, and services provided, essentially as a result of private decisions. This does not preclude some degree of public subsidy if the subsidy is sufficiently small and unobtrusive not to be a major factor. Private welfare, thus understood, has important advantages.

Advantages of Private Welfare

Information. People can be expected to know more than outsiders about their current and likely future circumstances and those of their intended beneficiaries. If their current and expected future incomes are adequate, they should be well able to provide for their own future needs and those of their intended beneficiaries. As people become richer and better educated, they are likely to want a more diverse range of services than that traditionally provided by the state. They are also likely to expect tailor-made assistance which builds on the strengths and takes account of the weaknesses of those who cannot help themselves.

Some examples to illustrate this point would be helpful. Many have argued that the role of the state should be limited to the alleviation of poverty and distress, and that other provision for old age should be a private responsibility. According to Arthur Seldon (1961:202):

> In a society which values personal liberty, which increasingly yields incomes high enough to permit saving for retirement, and in which people are capable of apportioning income between working life and retirement, arrangements will as far as possible be left to individuals. This [decision about provision for retirement] is an intimate, elemental, personal decision, and a free society will not lightly tamper with it.

People's circumstances and priorities change as they grow older and, ideally, this would be reflected in the investment strategies they adopt. Investors often have to choose between riskier investments with high expected returns and less risky investments with lower returns. Young people may be attracted to riskier assets with high returns: they may adopt a long-term strategy because they expect to be able to ride out occasional years when poor returns are earned. Those closer to retirement are more likely to be risk-averse.

If people have control over their investments, they can review their portfolios as circumstances change. Because of economies of scale, many superannuation funds are sponsored by employers rather than individual employees. The investment strategy is likely to reflect the average of the interests of individual members and, unless care is taken, conflicts of interest are likely to arise between individual members and the group as a whole (Bateman et al., 1990). The scope for people to adopt their own investment strategies would be restricted if tax-financed national superannuation replaced self-provision for retirement. It would be enhanced if a wider range of savings media enjoyed the advantages now given to superannuation.

Barry Bracewell-Milnes summarises the advantages of voluntary gifts over compulsory redistribution in the following way (1989:60).

> All redistribution, whether through the tax system or through giving and bequests, represents someone's idea of an improvement through a transfer of resources, a transfer from the less needy to the more needy if the concept of 'need' is made sufficiently wide; the money is in some sense thought to be put to better use in the second situation than the first. Compulsory redistribution through the tax system imposes administrative and compliance costs and excess burden, and the decisions are taken by third parties who are generally remote from the action and therefore likely to make mistakes. Voluntary redistribution through giving avoids compliance costs and excess burden; the administrative costs of giving to individuals are small or even zero; and decisions are taken by parties immediately concerned, often in full awareness of the facts.

Goodman and Nicholas (1990) argue that private charities are better able than government departments to direct assistance to where it is most needed and to minimise the adverse consequences of welfare, since they can give assistance as they see fit and can supplement assistance with counselling and follow-up services. Charities may minimise the cost of giving by: checking whether other sources of support have been approached; using volunteer labour; and taking advantage of donated goods and services. Gifts of goods and services have opportunity costs which would need to be taken into account in a full analysis. They may not be as cheap as they seem.

Goodman and Nicholas favour the greater use of private charity for the same reason that Robert Goodin would dislike it. The discretion exercised by charities may well result in the better direction of assistance to the needy but may also increase the scope for exploitation. It is a matter for judgment whether exploitation is a greater evil than unmet need; no doubt many would agree with Goodman and Nicholas that (at the margin) it is not. Goodman and Nicholas's proposal to increase the role of charities in providing welfare is discussed in Chapter 6.

Absence of compulsion. Private welfare is voluntary. A gift of capital, income or labour services is not made unless the donor values the gift in the recipient's hands more than if it remained in his own hands (the 'donor's surplus'). Gifts benefit both the giver and the receiver: the beneficiary receives the market value of the gift while the giver receives donor's surplus.

The essential requirement here is that the gift should be given freely and not in expectation of future reward. The sense of personal involvement because a donor has chosen his or her beneficiary may be valuable and is hard to replicate in tax-financed welfare programs which are necessarily impersonal. The taxes that are used to finance compulsory redistribution are more likely to be resented than paid cheerfully.

Bracewell-Milnes (1989:37–8) praises giving thus:

> The act of giving, like the quality of mercy, is twice blessed: it blesseth him that gives and him that takes. Note that it is the act of *giving* which is twice blessed, not altruistic sentiments which make the altruist feel good but stop short of doing anything for anyone else; these are fortunate if they are blessed once. The donor who turns sentiments into deeds turns ineffective into effective altruism. Where altruism is effective and a gift is made, the sum of donor's countervalue and donor's surplus exceeds the market value of the gift to the recipient: *it is more blessed to give than to receive* (Acts: XX, 35). And the gain to the donor is most as his joy in giving is greatest: *every man according as he purposeth in his heart, so let him give; not grudgingly, or of necessity: for God loveth a cheerful giver* (11 Corinthians: IX, 7). It is not often that heavenly rewards are so precisely anticipated on earth.

Competition. Private welfare is consistent with competition among those who provide it. This has two advantages. Competition can encourage the development of a range of services that reflects the diversity of individual needs and circumstances. This potential advantage will not be realised, however, if regulation is so strict as to preclude it. There may have been examples of this in recent years in areas such as health insurance and annuities. Second, competition makes it likely that services will be provided at or close to minimum cost.

Low political risk. A further advantage of private welfare is that, by comparison with government programs, it is relatively immune from political risk. Government social-security and welfare policies have often been based on electorally advantageous coalitions of interests constructed by political parties. This has resulted in changes in policy, depending on economic conditions and the prevailing climate of public opinion. A good example is the introduction by the Whitlam Government of a pension free of means test for person aged over 70 years, and its subsequent abandonment. One reason for the growth of interest in superannuation in recent years is the spreading belief that one cannot rely on the age pension. But, by comparison with some other forms of investment, superannuation enjoys favourable treatment by income-tax legislation. (Savings via home ownership receive even more favourable taxation treatment.) This legislation has been frequently changed in recent years. Concern has been expressed that the assets accumulating in superannuation funds may be used in part to achieve political ends rather than being invested in the interests of contributors.

Some other forms of private saving (for example, home ownership) are less obviously affected by tax legislation and have enjoyed a more stable environment.

Although private welfare may be less affected by political risks than government programs, it may be more subject to other types of risk. This will be discussed later.

Tax finance. The final advantage of private welfare is that it avoids the problems of tax finance that were discussed in Chapter 3.

Should Individual Preferences Ever Be Over-Ridden?

Private welfare has important advantages that a well-designed welfare system would attempt to harness as far as it can be consistently with society's overall objectives. Before drawing conclusions as to what this maximum extent might be, it is important to consider the disadvantages of private welfare and how serious they are. Although few would be comfortable with an entirely private welfare effort, private welfare could in many cases supplement or replace government provision.

The first disadvantage is that individuals may not always be the best judges of their own interests. Society, collectively, may then decide that the individual preferences of some of its members should be over-ridden.

Most readers of this monograph probably agree that people are usually the best judges of their own interests. This accords with our everyday experience of life and is a fundamental aspect of the case for a liberal society. Even so, society does not always allow individuals to act on their preferences. For example, we do not allow parents to deny their children formal education. And the choices that can be made by people with severe mental illnesses are restricted.

But beyond these obvious examples, there are good reasons for rejecting the argument that governments or experts know more about what is good for people than the people do themselves. Consider, first, retirement incomes. It is frequently argued that, left to themselves, people will not provide sufficiently for retirement. The pleasures of immediate consumption may be so attractive that long-term saving is ignored. Recognising both their weakness and that they will be provided for when their turn comes to retire, people may be happy to contribute to tax-financed, government retirement income programs.

It is, however, by no means clear that people would under-provide for retirement if left to their own devices. Although the attractions of immediate consumption are understandable, fear of an impoverished old age may provide a powerful offsetting incentive. Some indeed, have argued that on average people over-save for retirement. This is because of 'longevity risk': the uncertainty of length of life and the wish to ensure that enough is saved to provide, if necessary, an adequate standard of living in very old age. Those who die earlier leave bequests.

People can commit themselves to save for retirement in many ways (including private superannuation and home ownership). Moreover, private savings might well be higher if government savings were lower than they are now in Australia, or if government spending on items (such as pensions) that are an alternative to private saving were also lower.

Some people make bad, or unlucky, decisions about retirement savings; hence the need for backup programs. But governments also make mistakes and the consequences of their mistakes are more serious than those of mistakes by private individuals. On balance, there appear to be good reasons for obtaining a high degree of private involvement in the provision of income in retirement.

It is often argued that access to health and welfare services should be provided on the basis of assessment of need by experts rather than according to individual effective demand. After all, the patient would need to be a doctor to understand as much about his or her condition as a doctor does. To ensure that collective rather than individual preferences come into play, prices to users are either absent or unimportant and the service is financed largely through government subsidy. Government is involved to a high degree either in providing the service or in the reimbursement of private practitioners.

Dealing with 'Information Asymmetries'

The nub of the argument, therefore, concerns the discovery of 'information asymmetries' between professionals and their clients. These appear to give professionals an advantage in dealing with their clients and it is often argued that government regulation is necessary to provide a source of countervailing power. But other strategies for dealing with information asymmetries exist and these offer certain advantages. For example, the scope for competition might be enlarged.

Green and Cromwell (1984) point to the success of friendly societies in providing cost-effective health and welfare services to their members in the early years of the century. The friendly societies contracted with medical practitioners for the treatment and care of their members. In more recent years, subsidised health insurance for fee-for-service medicine has precluded the development of alternative (and perhaps better) service delivery methods. Interest in the Health Maintenance Organisations that have appeared in the United States has occasionally surfaced in Australia, but without much visible effect. Recently, Scotton (1990) and others have suggested that greater competition could be provided in the delivery of health services if health-insurance organisations were able to develop a variety of packages of services for their members. People then could choose to have their Medicare benefits paid to the organisation of their choice. To give organisations an incentive to minimise cost, reimbursement would be based not on the actual cost of services but on the expected cost, based on the characteristics of the contributors. Health-insurance organisations would be able to contract, as they saw fit, with public or private sector providers for the delivery of services.

This proposal, then, deals with 'information asymmetry' through competition between health-insurance organisations. Organisations that develop cost-effective methods of service delivery would be able to attract customers through lower premiums. The lower the subsidy of fee-for-service medicine and public hospitals, however, the greater will be the feasibility of competition. Governments may have to make compromises between equity and efficiency objectives.

It is increasingly recognised that governments should move towards contractual arrangements for the delivery of specified services (see, for example, the Home And Community Care [HACC] Working Group, 1988). These contracts could be awarded on the basis of competitive tender and could be available to commercial as well as non-profit and public service organisations. Interest is also growing in the use of the 'brokerage model'. A broker, acting on behalf of a client, would tailor to his or her needs a package of services that could be purchased under contractual arrangements. This would provide an alternative method of dealing with information asymmetries consistent with private delivery of services and competition.

In summary, the claim that the state has to be involved in the delivery of welfare because, in these vital matters, people are not good judges of what is in their interests, seldom holds true. This argument justifies public production only rarely; it justifies government subsidy sometimes but less often than is frequently thought.

Market Failure

The second group of arguments for limiting private welfare spring from market failure. For technical reasons it is argued that markets are unable sometimes to guide resources to their most profitable uses. For example, it has been suggested (e.g. by Barr, 1987) that:

- because of economies of scale, income support and welfare services are best produced by government-owned monopolies;
- the problems of private insurance require income support and health insurance to be provided by governments;
- if governments provide a welfare safety net, the rate of return to private saving will be reduced for many people. Compulsion is required to ensure that enough is saved for retirement;
- the provision of welfare services results in the production, as a by-product, of 'public goods', whose benefits cannot be appropriated by particular individuals. Government intervention is required to ensure that the right level of welfare services is provided.

Economies of scale. The argument about economies of scale is not convincing. There are some economies of scale in insurance and superannuation: entry and management fees per dollar of premium tend to be smaller for large superannuation funds than for smaller ones. But these economies of scale are not so large or persistent as to prevent the emergence of competition in these markets.

Nektarios (1984) argued that capital markets limit private savings by failing to provide scope for small investors to hold a sufficiently diversified portfolio of assets. However, a number of financial instruments (such as pooled investment funds) do just that. Although there may be economies in bulk purchasing (Goodin, 1988:240), coordination may be more costly in large organisations and costs in general may be excessive where competition is not permitted. Competition results also in a diversity of services. Where governments allow competition to take place on roughly equal terms, a number of service providers normally emerges.

Adverse selection and moral hazard. Government provision of health insurance, retirement incomes, unemployment benefits and so on has frequently been justified by arguments about the limitations of insurance markets. These arguments concern adverse selection and moral hazard. 'Adverse selection' refers to the tendency for insurance policies to be attractive to the worst risks. (The problem arises because perfect discrimination between risks is likely to be unrealistically costly for insurance companies.) Thus, health-insurance policies are most attractive to those with the poorest health, superannuation policies to those who expect to have the longest retirement, and so on. At any given price, the best risks choose to carry their own risk rather than to purchase insurance. Insurance companies have to allow for this when setting premiums. 'Moral hazard' refers to the possibility that insurance purchased subsequently influences people's behaviour. Those who have purchased unemployment insurance may choose to indulge in more frequent, or longer, spells of unemployment than otherwise. Insurance companies can reduce the importance of adverse selection and moral hazard, but they cannot eliminate them. In some cases they may choose not to offer insurance at all to certain classes of risk. This may be inequitable but is not necessarily inefficient.

The problems inherent in private insurance schemes, which arise essentially from the limited amount of information about their contributors that insurance companies find it worthwhile to collect, apply equally to government programs. But governments can enforce participation. Although this may be more equitable, it may also be costly in economic terms since many people are being provided with a benefit whose price is less than the marginal cost of providing it. The problems of insurance markets are to do with equity rather than efficiency (equity is discussed further below).

Means testing. Safety nets are means-tested. People who expect in retirement to have incomes in and around the means-test range have a reduced incentive to save. Some have suggested, therefore, that governments should either provide retirement income programs or require, or through tax advantages encourage, additional private savings. Yet the increased tax rates needed to finance retirement programs or to fund tax advantages for savings have efficiency consequences that may be just as serious as those of means testing. Contributions to compulsory savings programs resemble taxes to the extent that the programs succeed in inducing people to save more than they otherwise would have done.

The design of means tests to minimise their efficiency consequences is clearly important. By international standards, Australia uses means testing extensively in its social-security arrangements. Some writers (such as Logan, 1991) have suggested that greater use should be made of means testing in health to direct government assistance to the needy. As noted in Chapter 1, the New Zealand Budget of July 1991 introduced a means test for its previously means-test-free pension program, and also imposed user charges on the better off for health care. Does all this means testing really help governments to reach their equity and efficiency objectives?

The effects of means testing on economic incentives are complex. The most obvious effect is that high effective marginal tax rates (EMTRs) arise from the combined effects of taxes, social-security income tests and other targeted programs for housing and education. Empirical analyses show that relatively few people are in areas of the income distribution where they face high EMTRs. It has often been suggested that the beneficiaries of income-tested programs should not face EMTRs higher than the top personal income tax rate. This idea was the genesis of the proposals for a negative income tax that were first put forward in the 1960s.

These matters are even more complex than they were originally thought to be. Consider the effect of introducing a means test for a benefit that was previously means-test free. First, those with incomes in and above the abatement range (the range of incomes over which assistance is tapered away) are made worse off by the change. They receive a reduced benefit or no benefit at all. Some of them may decide to work longer, save more or offer additional services to the market to restore their previous standard of living. Second, the means testing makes possible reductions in government spending and so permits a reduction in general tax rates. The advantages of lower tax rates for growth and economic welfare were discussed above. Third, however, those in the abatement range face higher EMTRs than previously. This may encourage some of them to reduce their means by enough to qualify for the maximum benefit. Whether this is worth doing depends in part on the generosity of the maximum benefit. (Some of those with means just above the abatement range may also decide to qualify for maximum benefit.)

Means testing, therefore, is often on balance **favourable** to economic growth and welfare. This is particularly so if benefits are no more generous than is necessary and means testing is tight enough to phase out assistance at a low level of income. Only a small proportion of the population would then be subject to the adverse incentives that result from means testing.

The Family Allowance Supplement program does quite well in these respects. Only a small percentage of working families qualify. In contrast, some 60 per cent of the relevant age group qualify for the full Australian age pension (or equivalent) and a further 20 per cent receive a pension that is reduced through the means test. These percentages may fall over the next few decades as greater emphasis is placed on private saving for retirement.

Some people have argued recently that sole parents should face less stringent means tests to encourage them to work part-time. A less stringent income test could well achieve this objective. But some sole parents who are now working full time might decide to work part-time. Some adults in two-parent families might also decide that a combination of sole parents' pension and part-time earnings is preferable to their present situation.

But what about the 'skyscraper' diagrams that were produced, for example, by EPAC (1988), showing the combined effects of several means tests? Is this not the *reductio ad absurdum* of means testing? I think not. The problem arises not because of the amount of means testing that occurs in Australia but because the separate income tests that exist are poorly coordinated with one another. Recent improvements in information processing has made it possible to use a single means test for all targeted programs. Under this approach, the amount of targeted assistance available to a particular family would be aggregated, and the total would then be abated according to a family's means at an acceptable rate (say 50 cents in the dollar). Very high EMTRs would be avoided. One the other hand, assistance would be tapered away as quickly as possible given the abatement rate, thus minimising costs. The single income test would therefore minimise the disincentives arising from the provision of a given amount of assistance to the needy.

Public goods. The final market-failure argument against relying on private welfare is that the market, if left to itself, will not provide a sufficient quantity of the public goods that are by-products of welfare services. (Public goods are goods which, if they are available to one person, must be available to all. Since no one can be excluded from the benefits of public goods, individual consumers cannot be made to pay for them. This means that the market is unlikely to produce sufficient public goods.)

Several examples of the public goods which are of relevance here have been suggested. For example, we all have an interest in the productivity of people who work in future and may be concerned that poor families will not do enough to care for and educate their children. Some government action to alleviate child poverty may therefore be justified on these grounds. Charity may be a public good (see below). Many of us prefer to live in a society in which extreme poverty is absent. This may be a further argument that would justify a minimal welfare state.

Equity Arguments

The most important reason for dissatisfaction with private welfare is concern that, without government assistance, it may not be forthcoming in sufficient quantity to satisfy society's conception of economic justice. There are three main such equity arguments against private welfare. First, there is a danger that the coverage of private welfare will be incomplete. Some people may not have earned enough to provide for retirement or may have made unwise or unlucky investment decisions during their working lives. Some children and some aged or disabled people may lack a 'particular other' on whom they can rely. Unpopular groups may not receive their fair share of charitable donations. A shortage of volunteers may threaten the delivery of some welfare services. It may be very costly to provide some people with insurance. And so on. As we have seen in Chapter 2, the unavailability of private welfare was an important reason for initiating government programs in Australia in the early years of this century.

Second, private welfare may give rise to free riding on the efforts of others. The relief of distress is everyone's responsibility. But it is in the interests of each person to let someone else pick up the bill. If everyone acts like this, no private welfare would be provided. This provides a strong argument for governments requiring citizens to participate in programs for the relief of distress. This may involve the payment of taxes or, as Goodman and Nicholas (1990) argue, compulsory contributions to charity. But it is interesting to note, as was pointed out in Chapter 2, that donations to charity are far from insignificant, despite the temptation to free ride. Gifts to 'particular others' are very important indeed.

Third, private welfare reflects the preferences of donors rather than those of recipients. As we have seen, Goodin argues that this gives rise to the danger of exploitation of the abjectly dependent, whereas the actions of those who work in government welfare programs are more accountable to the recipients. Even here, however, the preferences of the wider society are far from being unimportant.

These equity arguments are important. They suggest that, although private welfare has an important part to play, there are limits on what can reasonably be expected from it. But the advantages and limitations of government welfare should be examined before conclusions are drawn about what the respective roles of private and government welfare should be. This is the task of the next section.

Advantages and Disadvantages of Government Welfare

By 'government welfare' I refer to those payments that are made, or services provided, essentially because of government decisions. This precludes private-sector involvement except where private organisations act, under strict guidelines, as the agents of government in providing services. Examples of government welfare include: pensions and benefits, State government concessions (for rates, public-transport fares and so on), public housing and government-provided child care and nursing-home services.

Governments can compel people to take part in the welfare programs that they run. The comparative advantage of government welfare programs is in providing services and benefits that will — or may — not become available through private effort. Government programs are therefore ideal for providing a residual welfare safety net. In contrast, government welfare is less satisfactory in supplementing the welfare safety net with benefits and services that are consonant with individual needs.

Some writers have doubted whether government programs are very good in achieving this safety-net objective. For example, government programs that were set up to help the poor may be attractive for other groups. Middle-class involvement in welfare, however, is not only wasteful but may well result in a reduced level of assistance for the poor.

Goodin and Le Grand argue that it is almost inevitable that the middle classes will be involved in welfare programs that were not introduced for their benefit. They list (1987:204–5) the many ways in which this could happen:

> Being better-educated, the non-poor are better at manipulating complex bureaucratic rules to their advantage. Having more private resources (such as cars and telephones) and more flexible working hours allows them to take better advantage of services that are universally available to all alike. . . Even when programmes are notionally targeted on the poor, the non-poor may still be the incidental beneficiaries of tendencies for bureaucracies to grow and for boundaries of 'need' to be ever-expanding. In addition, the middle class are collectively politically powerful and individually adept at arranging their affairs so as to make themselves appear 'poor' within the terms of any particular programme's means test, both of which might lead to heavy non-poor participation in programmes designed to benefit 'only the poor'. On the evidence from Australia, anyway, it is the last of these —individual behavioural responses — that seem most important in accounting for non-poor participation in means-tested programmes.

Goodin and Le Grand's prime exhibit is the Australian age pension. Between 1945 and 1981 the proportion of the relevant age group receiving the pension increased from one half to three quarters. The proportion of the population receiving an age or service pension peaked at around 85 per cent in the early 1980s but has since declined (Social Security Review, 1988:14).

No doubt changes in values and fashions have played an important part in leading people to be more willing to bring themselves within the criteria for pension eligibility. Even so, the evidence points to the importance of an alternative, economic, explanation that may permit a more hopeful conclusion for the future of social policy. Note, first, that the attractiveness of reliance on the age pension depends on the generosity of the pension and the means test. The more private income a person can have and still receive the pension, the more attractive it will be to be a pensioner. Most of the increase in the share of the relevant population that receives the pension occurred between the mid–1960s and mid–1970s (see EPAC, 1986:11). During this period benefits became more generous in terms of average incomes, and means tests were, in general, eased. These trends were reversed during the 1980s and the proportion receiving the pension has fallen. The proportion may rise again once people learn to work their way around the new means tests.

Even so, there does seem to be evidence that pension coverage is controllable to some extent — given the will to control it.

Peter Travers (1989) has recently argued that the rise in the proportion of the relevant population receiving the Australian age pension during the 1960s and the 1970s was the result of policy change rather than behavioural change. During the 1980s policies such as the introduction of an assets test restricted the proportion of the relevant age group that received the pension. This, in Travers' view, is part of a developing consensus that the objective of social policy should be poverty alleviation. The increased emphasis given to child poverty during the 1980s is another aspect of this consensus.

Goodin and Le Grand may well argue that the effect of such measures as the assets test will be only temporary. People will learn to work their way around the new arrangements and the proportion receiving the pension will then rise. But, provided that the will existed to maintain an anti-poverty objective for social security policy, other measures would then be found to restrict eligibility.

As part of their study of the privatisation of welfare, Goodman and Nicholas (1990) report on an analysis by the US General Accounting Office of benefits available to sole mothers in Dallas and Boston. Welfare benefits are much more generous in Massachusetts than in Texas. Goodman and Nicholas conclude as follows:

> It appears, then, that Boston's lavish welfare benefits, doled out to people who were not all that needy, were discouraging productive work, and that removing these benefits spurred them to increase their work effort. By contrast, in Dallas, where AFDC mothers had a greater need and less ability to compete in the marketplace, welfare benefits had only a moderately discouraging effect. (1990:21)

I hesitate to recommend the Texas welfare system; it may be far too stingy for Australian sensibilities. But the comparison between Dallas and Boston does suggest that the social and economic effects of government welfare programs are at least potentially controllable.

The provision of a basic safety net only would be an unexciting role for government, and it is understandable that those who work in government social services might well prefer an expanded role. David Willetts (1989:94) writes about the situation in Britain as follows:

> Nowadays we are often told in Britain that the purpose of social security is to help the poor. This belief is particularly held by people on the right and was part of the rhetoric surrounding the government's recent welfare reforms. Politicians find them-

selves impaled on a dilemma as the presumption is often that a leaner, fitter social security program will target help on the poorest members of society. Yet it is these programs which have less of a political constituency. The politically most popular programs — the ones most difficult to cut — are the universal contributory benefits, notably the pension.

In summary, it seems to be possible, through the careful design of programs, for governments to direct assistance to the poorest. But, in reality, social security programs are likely to be a compromise between the desire to assist only the needy and political attractiveness, simplicity and so on. Unless care is taken, the incentives facing politicians and officials may encourage them to allow the middle class to enter programs that were not originally designed for their benefit. (The incentives facing politicians and officials are discussed further in Chapter 7.)

Conclusions

It would be useful to summarise the main points made in this chapter.

- Governments should, on moral grounds, ensure the availability of basic welfare. Indeed, only governments can do this.
- Much income redistribution and provision of welfare services results from private effort. These activities have important advantages in leading to a diversity of services in line with people's diverse individual interests and circumstances. It is important that government programs should discourage private welfare as little as possible.
- To the extent that poverty alleviation is the objective of government programs, care must be taken to ensure that benefits do not flow to the middle class.
- It is often advantageous to involve the private sector in the provision of government welfare. This is particularly the case if the programs are based on clear objectives, are directed to need, and allow for competitive tendering for the right to produce the service.
- The involvement of private effort in the delivery of welfare is being encouraged by the desire of a prosperous and well-educated population for a more diverse range of welfare services and by developments in information processing.

Chapter 5

The Crowding Out of Private Welfare by Government Welfare

The crowding-out argument holds that because government does so much, people do less for themselves or for others than they otherwise could.

The Dimensions of the Argument

The crowding-out argument has both factual and moral dimensions. First, one can look for evidence about the amount of crowding out that has taken place in recent decades. Most observers accept that a good deal of crowding out has taken place. The evidence, reviewed below, suggests that they are right and this may not be surprising. One reason for introducing welfare benefits (such as the Supporting Parents Benefit) has been to assist people in certain circumstances to live independently of their own efforts or of those of the particular others on whom they previously relied. Moreover, not only has the welfare state made it less necessary for people to provide for their own welfare or that of particular others, but the higher tax rates entailed by the expanded welfare state have reduced their capacity to do so. As was shown in EPAC (1988), the increase in the income-tax burden since 1950 has been particularly great for taxpayers with dependants. (This has been offset for low-income families by the introduction of means-tested assistance.)

Second, one can attempt to assess whether the changes in lifestyles induced by the growth of the welfare state have been desirable. To sceptics such as Giersch (1989:9) the welfare state must be contained 'because it has the tendency to constrain the citizen; to make the family, savings and provision for a rainy day superfluous; to narrow the extended self-interest; and to let the community spirit wither away'. The welfare state treats its citizens as being immature and spreads a dependence mentality. Self-respect and self-reliance are thereby lost.

Supporters of the welfare state (such as Ringen, 1987) argue that the lifestyle changes have been desirable. For example, the pensions and home-help services that government provides have enabled older people to live in their own homes and away from their families. The growth of the welfare state has provided job opportunities for women, and, through government-provided child care, has enabled women to take up these opportunities. Similarly, pensions for sole parents have enabled women and children to live apart from violent husbands and fathers.

Particular attention in this chapter is paid to the changes in lifestyle that have resulted from the growth of the welfare state. I then draw conclusions about the circumstances in which crowding out is likely to be undesirable.

Identifying the Effects of the Welfare State

In studying crowding out, the effects of the growth of the welfare state must be distinguished from those of the simultaneous increase in affluence. An important social change over the past generation has been the increase in individual autonomy: we are less willing to be dependent on particular others than we were. This can be seen, most fundamentally, in the statistics on household size. Whereas the average household size in the 1966 Australian census was 3.5 persons, this figure had fallen to 3.1 persons in 1976 and to 2.9 persons in 1986.

Individual autonomy is, in economic terms, a normal good. We feel we can afford more of it as we become richer. The demands of modern economic growth often make it seem attractive for people to live apart from their families or for women to enter the labour force.

The crowding-out argument is related to, but different from, the argument that welfare programs reduce earnings and savings during working life. It seems fairly clear, for example, that government programs crowd out self-provision as a source of income in retirement (see below). However, the effect of welfare programs on saving is less certain (see Chapter 3 above). It may be that the availability of pensions in retirement encourages people to save to finance early retirement. They may choose to run down their assets and rely on the pension once age-pension age is reached.

As noted, many welfare-state policies have had the effect (or, indeed, the intention) of making it easier for people to live independently of particular others. But the same result might well have been achieved through other means had the welfare state not expanded. Government-provided home-help services help older people to live independently; but so do commercially-provided services and assistance from neighbours and relatives. The Supporting Parents Benefit enables parents to live apart if they so wish; but in the absence of such payment greater stress would probably have been laid on establishing and enforcing maintenance obligations. Australia and New Zealand are now placing greater emphasis on child support from absent parents as an alternative to taxpayer-financed sole-parent pensions.

Two implications follow from this. First, the welfare state may have been a less powerful force for good or evil than is frequently thought by its defenders or its opponents. Similar results may well have been achieved by other means in the absence of welfare-state expansion. Second, much of the expansion of the welfare state may simply have been unnecessary.

Australian Evidence of Crowding Out

The changing incomes of the aged. Some years ago, David Murray (1979) drew attention to the changes in the principal source of income of older people in Australia. Successive income surveys undertaken by the Australian Bureau of Statistics have shown that earnings became a less important source of income for the aged over the period from the mid–1960s to the mid–1970s when eligibility for the pension was extended.

The principal source of income of people aged over 65 years in 1969 and 1986 is shown in Table 3 below.

Table 3
Principal sources of income for people aged 65 years and over

	1969 survey (Income recipients) %	1986 survey (Income units) %
Wages and salaries	10.1	1.8
Own business, trade, profession	5.6	1.4
Other private income	19.4	18.0
Pensions and benefits	65.0	78.8
	100.0	100.0

Sources: 1969 Survey ABS (1973); 1986 Survey ABS (1989i)

The 1969 data are for income recipients but the 1986 data are for income units. (A husband and wife would count as one income unit even though both of them might receive income.) The data suggest that receipt of income by more than one member of the income unit was not common in 1969. Thus, it may be quite reasonable to compare income recipients in 1969 with income units in 1986. This comparison shows that the proportion with incomes principally from wages and salaries or from business or a profession has fallen; the proportion with incomes principally from investments has remained about the same; but the proportion with pensions and benefits as a principal source of income has increased from 65 per cent in 1969 to 79 per cent in 1986.

There is a deal of evidence to suggest that the labour-market and asset-holding behaviour of older Australians is influenced by the incentives generated by tax and pensions systems. Recent Australian studies include Anstie (1989), Cox (1986) and Woodland (1987).

Responses to the introduction of new benefits. One of the most controversial of recent social-policy changes has been the introduction of Supporting Parents Benefit in 1973. Sole-parent families increased from 9 per cent of all families in the mid–1970s to around 14 per cent in the mid- 1980s. The number of sole-parent families increased from 183 000 in 1974 to 316 000 in 1985 (Commonwealth of Australia, Cabinet Sub-Committee on Maintenance, 1986:7). In the overwhelming majority of cases sole-parent families are the result of the break-up of marriage or de facto marriage; in most cases another parent has in the past shared responsibility for the expenses and care of children.

It is tempting to conclude that the large increase in sole parenthood has been due to the Supporting Parents Benefit (Swan & Bernstam, 1989). This may be largely true. But growth in numbers of sole parents may also be the result of wider social changes (such as a reduced willingness to stay in unrewarding marriages) which may well have occurred even if eligibility for pensions and benefits had not been widened.

Regardless of one's views on this matter, government welfare has undeniably replaced private welfare in meeting the costs of children in sole-parent families. Even though the combined incomes of the former partners are unlikely to have fallen much because of separation, the ready availability of government pensions has made it unnecessary for sole parents to rely on private sources of income (such as maintenance) to any great extent. Indeed, until recently, the Family Law Act did not require courts to disregard the eligibility of custodial parents for social-security pensions when awarding maintenance. As noted, the recent changes to child support will reverse this situation to some extent.

Recent proposals to introduce and extend benefits for the young homeless give rise to similar concerns. Rising numbers of young homeless people may well reflect broad social trends (such as a reduced willingness by parents and children to endure an irksome relationship). Allowances for the young homeless may fuel such growth. Even if they do not, there is likely to be a significant transfer of the responsibility of financing the expenses of young people from private sources to the taxpayer. Many would argue that the needs of the young unemployed are best met by private organisations that can provide advice and support as well as cash.

Financing the expenses of the unemployed. Peter Travers (1983) has carried out a study of the life histories of a group of men who were born in Australia between 1905 and 1917, were unemployed during the 1930s, and lived in Adelaide during the 1980s. According to Travers, the three key characteristics of his sample are that, at the time of their unemployment, they were not married, they lived at home with their parents, and had only marginal contact with the welfare system.

> Keeping in mind that one of the main effects on health would come via poverty, and our description of the punitive nature of the South Australian welfare system, these are crucial features. Not a single respondent to date claims ever to have gone hungry while unemployed. They are quick to point out that the real burden of finding food rested with their parents and, above all, their mothers. They themselves do not recall going without food. . . They certainly experienced poverty in the sense that they never had cash. There is some paradox in this picture of men having no cash whatsoever, yet never going hungry, yet this seems to have been the lot of this particular age cohort. (1983:43)

The introduction of unemployment benefits from the 1940s has shifted the burden of meeting the expenses of the unemployed from their families to the general taxpayer.

Evidence from Abroad

Care of the aged in Sweden. In *The Possibility of Politics*, Stein Ringen (1987:129–36) includes an interesting discussion about the care of the aged in Sweden. In 1954 more than 25 per cent of the elderly lived with a child or children of their own; in 1975 less than 10 per cent of the elderly lived in this way. According to Ringen, 'The elderly have become more dependent on government but they also have more income and better services. They are less dependent on family, but this is because they wanted more independence and now have the means to achieve it' (1987:134). Government welfare has therefore replaced private welfare and this, according to Ringen, has been what elderly people and their children want. (Home-help services appear to reinforce, rather than replace, care by family members.) But as noted earlier, the aged may well have been able to achieve greater personal independence even in the absence of growth in the welfare state.

Private giving in Britain and the United States. Jeffrey Obler found that Americans give seven times as much to charity as do people in the United Kingdom. Some of this difference is due to higher average incomes in the United States and some to a more favourable taxation treatment of charitable contributions there. However,

> giving in Britain, as compared to the United States, is especially weak in those areas where the state is especially involved, even though donors in nearly all areas of charitable giving operate under the same tax provisions. But in those areas in which the state plays a more negligible role private giving has been more robust. (1981:30)

Based on a study of private giving in an English village, Obler concludes that unilateral personal giving aimed at particular disadvantaged individuals has largely been replaced by welfare-state services. Other forms of giving have been less adversely affected, including cooperative effort in those areas of life (e.g. the development of community facilities) in which the state takes only a passing interest.

Charles Clotfelter has studied the effects of fiscal policy on charitable donations in the US. Despite the observed relationship among nations between the size of government and the strength of private giving, Clotfelter does not find a strong crowding-out effect (1985:275). The amount of donations varies with the general effective tax schedules and the specific incentives for charitable contributions. Tax deductions for charitable contributions are worth more if **marginal** tax rates are high, and the amount of charitable contributions may be correspondingly higher. Low **average** tax rates may also encourage charitable contributions by leaving money in the pockets of taxpayers. These relationships should be kept in mind when examining changes to the taxation laws, particularly if it is thought that charities are more efficient than government.

The private rental market in Australia and New Zealand. There are substantial tax advantages for owner-occupied housing in both Australia and New Zealand. Few people believe that they can afford to forgo the advantages of owner occupation and most achieve owner occupation at some stage during their lives. But home ownership has disadvantages: a house is a lumpy and a risky asset. And home ownership makes it harder for people to move to change jobs. If the taxation and social-security treatment of differing housing tenures were neutral, the percentage of home owners could be lower.

New Zealand and Australia have taken slightly different views about the private rental market in recent years. The amount of heavily subsidised state rental housing has been growing strongly in New Zealand. Only small subsidies have been available to the tenants of private landlords. (However, in July 1991 the New Zealand Ministry of

Housing announced that a means-tested Accommodation Supplement would be introduced for home owners and for tenants of both state and private rental housing; tenants of state housing would be charged full market rents.)

Meanwhile in Australia the environment for private landlords has always always been more favourable. This can be seen most obviously in the favourable taxation treatment of the expenses involved in earning a rental income: these can be deducted against the taxpayer's other income. As a consequence, the private rental market in Australia is substantially larger than it is in New Zealand. Whereas 25 per cent of Australian households are private renters and 5 per cent rent government-owned accommodation, the figures for New Zealand are 21 per cent and 7 per cent respectively.

The same approaches of unsympathetic regulation of the private alternative and subsidisation of the government-financed alternative may, as discussed in Chapter 2, have contributed to the growth in spending under the Commonwealth government's Children's Services Program.

Sole parents in the United States. Ellwood and Summers compare the number of children in households headed by women in the US with the number of children in households receiving Aid to Families with Dependent Children (AFDC), the main benefit for sole-parent families. The number of children in sole-parent households increased sharply between 1970 and 1980. But because of reduction in real benefits (and hence eligibility), the number of children in households receiving AFDC remained constant over that period. It seems unlikely that benefit levels were the fundamental reason for the growth in the number of sole-parent households. Ellwood and Summers are similarly unable to find a relationship between benefit levels in the different states and the fraction of sole-parent households.

Ellwood and Summers are, however, concerned that the bulk of expenditure on AFDC goes to a group that is dependent on welfare for an extended period. They argue (1986:98) that:

> The peculiar nature of the welfare problem for single mothers is the fact that society generally encourages mothers to stay at home and care for children, but it also sees self-sufficiency as a virtue and is increasingly unwilling to accept welfare dependence among single mothers in the way that it accepts it among the disabled. Thus a program of high benefits and no work incentives, as is offered the disabled, is unacceptable. More complex regulations about work and child care are necessary.

> Diverse services must be offered, and some argue for work requirements. Pure transfer policies seem undesirable.

Ellwood and Summers are sufficiently concerned about disincentive effects to argue that welfare should not be extended further to adults without children or young people.

Although the effect of benefit levels and eligibility conditions on the number of sole parents in the US may be uncertain, these factors clearly influence the division between private and public effort in providing for the needs of sole parents. As noted by Goodman and Nicholas (1990), reductions in the generosity of benefits may have encouraged some sole parents to work. The laws concerning the payment of maintenance (or child support), and whether it is used to supplement or replace sole-parents' pension, also help to determine the division between private and public welfare.

Evidence from International Comparisons

As Ringen (1987) argues, different welfare states have different priorities. The small welfare states such as Australia and the US have anti-poverty objectives only. The large welfare states such as Sweden and Germany aim to achieve a sufficient degree of equality to eliminate 'societal cleavages which might cause conflict and tension in society' (1987:8). If the crowding-out hypothesis is correct, we would expect to find that self-provision among groups such as the aged is less important in larger welfare states than in small ones. If crowding out is 100 per cent — i.e. if an increase in government welfare crowds out an equal amount of private welfare — the aged will be no better off in the large welfare states. Since it takes time for people to adjust their plans and expectations, it may be a generation or so before the full effects of growth in government welfare on private welfare are experienced.

Comparable international data from the Luxembourg Income Study has facilitated study of the effects of different social policies on economic well-being. However, the Luxembourg Income Study is not perfect and considerable care needs to be taken in interpreting the data.

Data from the Luxemburg Income Study support the following generalisations (see OECD, 1988, Gruen, 1989, and Smeeding et al., 1990, for further discussion):

- Earnings from personal exertion and income from property tend to be relatively unimportant sources of income for the aged in countries such as Germany and Sweden, which have large welfare states.

- As a result, when a standard poverty line is applied to the incomes of the aged, a large percentage of the aged are found to be in poverty.
- The large welfare states are, however, quite successful in raising the aged out of poverty.
- In contrast, earnings and income from property tend to be greater, and hence pre-transfer poverty tends to be less, in the smaller welfare states. These welfare states seem, however, to be less successful than the larger ones in raising the aged out of poverty.
- The extent of pre-transfer poverty among the non-aged poor depends on their ability to obtain income from earnings or child support. Once again, the larger welfare states seem to be more successful than the smaller ones in raising the pre-transfer poor out of poverty.
- In general, the countries with the highest levels of poverty reduction are also the countries with the highest pre-transfer poverty rates.

So far as the aged are concerned, Australia appears to be a typical small welfare state. Pre-transfer poverty is less than in some other countries but the effectiveness of the social-security system in taking people out of poverty is less than in those countries with larger welfare states. Australia has, however, a higher level of poverty among children, both before and after transfer, than most European countries.

This unflattering view of the Australian social security arrangements has not gone unchallenged. Gruen (1989) has suggested that the Australian arrangements appear in a better light if account is taken of some problems with the Luxembourg Income Study. First, no account is taken of income in kind either from pensioner fringe benefits or subsidised health care, or from the ownership of assets such as dwellings and consumer durables. Home ownership is likely to be particularly important in the English-speaking countries (such as Australia), which tend to have small welfare states. Thus the Luxembourg Income Study may well understate both the pre-transfer standard of living of low-income groups in the small welfare states and the effectiveness of these welfare states in taking people out of poverty.

Second, the poverty estimates include a standard equivalence scale to take account of the different needs of families with differing sizes. The results obtained are very sensitive to the particular equivalence scale chosen (see Buhman et al., 1988); moreover, there is no good reason to expect the same equivalence scale to be appropriate for different countries. The choice of equivalence scale is a matter of some significance in Australia, where average family size is large by European standards.

Third, Australia ranks higher if the poverty gap (the amount by which the incomes of the poor fall below the poverty line) is considered rather than just the numbers of the poor.

These arguments cast considerable doubt on the conclusion that small welfare states are ineffective in taking people out of poverty. They do not cast doubt on the argument that income from earnings and property is low in those countries that have large welfare states. At least for the aged there seems to be a strong argument that government welfare eventually crowds out private welfare.

Summary and Conclusions

Supporters and opponents agree that the welfare state has changed the way that people live. Older people now live more independently of their children than they did in the past. Sole parenthood is now more financially supportable. The families of unemployed people are no longer expected to support them. Government has become more important as a source of income for older people and earnings have become less important. Private charity and voluntary effort have become less important and have been diverted to areas of activity where government involvement is relatively slight. Publicly-subsidised housing and child care has tended to drive out the less subsidised private alternatives. The growth of the welfare state has both provided jobs for women and, through subsidising child care, made it easier for women to take them up. But taxpayers with dependants have been particularly adversely affected by the increased taxes that have been required to pay for the expanded welfare state. This has reduced their capacity to provide private welfare.

Views may well differ about the desirability of these changes. I suspect that few people will regret that parents are no longer expected to support their adult unemployed offspring (although they seem increasingly to be expected to support those who are aged under 18 years). More people are likely to be concerned about the loosening of ties between family members that seems to have accompanied the growth of the welfare state. As noted, some changes would probably have taken place even in the absence of the welfare state. Women would have found jobs in other sectors of the economy. And private alternatives to government-subsidised home-help and child-care services would have developed to a greater extent than now exists.

The evidence presented above suggests that the crowding out of private welfare by government welfare is important. Having established the social safety net, many of us will be concerned that further expansion in government welfare will have an effect in discouraging private welfare that is disproportionate to the net benefits. This is particularly so if account is also taken of the disincentive and other adverse side effects of taxation. Proposals for expansion of government welfare should be scrutinised more carefully than has often been the case in the past.

These propositions have a number of implications for government policy:

- Governments should be careful about doing those things that individuals can do for themselves or for others; they may stop doing them. As argued in Chapters 3 and 4, the comparative advantage of government is in making the minimal welfare state available. Beyond this, a private alternative is often to be preferred.
- Governments should supplement and assist rather than replace the private welfare services that already exist. For example, home-help services could supplement the efforts of relatives, neighbours and the commercial sector in caring for the aged.
- To encourage competition and efficiency, government subsidies should be available on a similar basis to government-owned, commercial and non-profit making organisations.

These ideas are taken up in the next chapter.

Finally, a couple of points are worth making about the implications of this analysis for the adequacy or otherwise of Australia's social-security arrangements. First, the focus of concern should be the adequacy of the combined government and private welfare arrangements, not that of the government system alone. Second, the international comparisons that are frequently made show the Australian system in an unduly unfavourable light because they tend to ignore income in kind (e.g. home ownership), which is likely to be particularly important in Australia.

Chapter 6

The Potential of Private Welfare

This chapter looks at some ways of promoting greater private involvement in financing and delivering welfare services. I do not make detailed recommendations but indicate the broad directions of possible change.

The greater the extent to which the suggestions made in this chapter are taken up, the greater the extent to which the delivery of social security, welfare services and housing will be subject to competitive pressures. The greater the competition, the more likely services are to be provided in accordance with people's needs and at minimum cost.

It is, I think, useful to distinguish between those proposals that involve greater private participation to achieve more efficiently **government** objectives and those that would allow donors, rather than governments, to decide how their contributions can best be used. The first group of proposals includes:

- introducing competition in areas of service delivery where it presently does not exist;
- extending the scope for competition by allowing services to be provided by commercial organisations as well as by government and non-profit organisations;
- considering whether the private sector, perhaps subject to government regulation, can supplement or replace government effort;
- considering whether social objectives can best be achieved by the provision of cash payments as opposed to in-kind benefits.

The treatment of gifts and donations to charity in the income-tax legislation might be examined to enable private, rather than collective, preferences to play a larger part in determining the distribution of welfare. Goodman and Nicholas (1990) have recently suggested that taxpayers should be free to direct some part of their tax bill to one or more approved charities rather than to the Department of Social Security.

Most of the ideas in this chapter involve the greater use of prices (or user charges) for welfare services. The desire for something for nothing is, perhaps, understandable. And user charges may undesirably deter people from using services. But providing a free or highly-subsidised service frequently ties the recipient to a particular provider, so losing the advantages of competition. A greater acceptance of user charges would therefore have advantages. Distributional objectives could be met by payments to service providers or their representatives.

As noted elsewhere in this monograph, the Australian welfare system has characteristically used private effort to serve government-determined ends. In recent years, this aspect of the Australian welfare state has, if anything, become more important. The proposals made above for greater private participation in the delivery of public welfare amount, in some instances, to further development of existing policies of Commonwealth and State governments. These suggestions are quite likely to be taken up, particularly if continuing economic difficulties for Australia encourage increased interest in finding more efficient ways to achieve social objectives. But it is less likely that the next few years will see the replacement of welfare programs reflecting collective preferences by programs reflecting individual preferences.

Introducing Competition in Service Delivery

At present, many welfare services are provided by government departments (e.g. the Commonwealth Rehabilitation Service) or by non-profit organisations that enjoy a degree of monopoly in their local area (e.g. at least in the past, the Children's Services Program).

According to Graycar and Jamrozik, government departments and non-government welfare agencies are mutually dependent. Competition is absent or weak.

> The situation, however, is one in which substantial public resources are transferred to private hands. Accountability is slight and a dependency pattern is created whereby continuing funds are needed by the agency for survival and the government is locked into providing funds to the largest agencies. Past funding creates a situation where public and private are intertwined and which is difficult to dislodge. (1989:154)

Important advantages could result from the introduction of competition. Competition tends to ensure that the services that people want are produced and at minimum cost. This is as likely to be true for welfare services as elsewhere.

The main prerequisites for greater competition in the delivery of welfare services include: service planning on the basis of need; the specification of outcomes for the program (i.e. what is supposed to happen as a result); competitive tendering; and the drawing up of contracts between government and the service-providing organisation.

The greater use of contracts and competitive tendering in the public sector have been much discussed recently (e.g. by Rimmer, 1988, and the Evatt Research Centre, 1990). It should be noted that contracting and competitive tendering are not the same. A service can be provided by a non-government organisation without competitive pressures being present; this frequently occurs in the Australian welfare state. And a competitive tender may be (and frequently is) awarded to an in-house team.

As stressed earlier, an organisation has to be very careful to specify what is required before embarking on competitive tendering. Unless care is taken service quality may deteriorate; and drawing up contracts and monitoring performance are costly. The advocates of competitive tendering argue that these problems can be minimised through careful attention to the design of the tendering process.

Why is competitive tendering so little used in the Australian welfare state? Apart from the force of tradition, one reason is a belief that only a limited number of organisations have the relevant expertise. Another is that only a limited number of organisations can be trusted not to behave opportunistically in situations where objectives are not clearly spelled out. The truth or otherwise of these beliefs could be tested from time to time through experiments with competitive tendering. This is particularly important where new services are introduced or old ones are expanded. The difficulties with contracting and competitive tendering may have been overstated; in any event there now seems to be increased interest in specifying outcomes for such programs.

Greater competition could be introduced with advantage to many welfare services. The 1990 Commonwealth Budget emphasised and reinforced the obligation of pensioners and beneficiaries to take up rehabilitation and skills training where it is to their advantage to do so. Expenditure on these services will have to increase in the years ahead. The introduction of competition, where feasible, would do much to ensure that the additional expenditure was directed as successfully as possible. The Department of Social Security could seek tenders for the provision of particular services to particular groups of people. To make this work properly, the State TAFE authorities and the Commonwealth Rehabilitation Service would need to operate more commercially than at present.

The introduction of competition and a contract model of service delivery could help in the expansion of the HACC Program and community development services where important geographical inequities presently exist. Also, Area Health Authorities in New South Wales and their equivalents in other States might contract with public and private hospitals and, where relevant, home-nursing services for the efficient delivery of services for patients.

Successful introduction of contracting and competitive tendering will require departments to develop new skills in specifying objectives carefully, information processing and managing the contract process. It will take some time before these initiatives have their full effect.

The Extension of Competition

This option is a further development of the previous one. The scope for competition should be as extensive as possible to make it likely that the right services will be provided at close to minimum cost. This suggests that commercial organisations, as well as government and non-profit organisations, should be able to tender for contracts to deliver welfare services.

Several requirements will need to be met before this desirable outcome can be achieved. First, those running the programs must be able to put presuppositions to one side: the superiority of (for example) child care provided by government and non-profit organisations over child care provided by commercial organisations is to be tested, not assumed. Second, subsidies to government, non-profit and commercial organisations need to be roughly similar to make it possible to move towards a 'level subsidies playing field'. Third, care must be taken in specifying objectives and managing the contract process to limit the scope for opportunistic behaviour by commercial organisations.

In January 1991, the fee relief that is presently associated with child-care centres that are sponsored by the Commonwealth's Children's Services Program (CSP) was extended to 'eligible users of approved employer-sponsored, non-profit non CSP and commercial sector child care services'. This is undoubtedly a move towards the level subsidies playing field (although centres subsidised by the CSP enjoy other advantages). Fears have, however, been expressed that, unless care is taken, the process of approval may be unduly grudging. Competition may well be advantageously introduced and expanded in other areas such as home-care services.

Access to power, transport, water supply and telecommunications is regarded in Australia and similar countries as a right of citizenship. To ensure that they have access to these services, pensioners and some other groups are provided with subsidies. The cost of providing any given level of subsidy will probably be minimised if the services are provided competitively. This requires subsidies to be given in a way that does not preclude competition. For example, governments could pay subsidies from general revenue to all participants in the market to promote access. Alternatively, as discussed below, subsidies could be paid to eligible individuals. Competition is, however, inconsistent with cross-subsidy, i.e. where some customers are charged in excess of marginal cost so that others can be provided with services that are priced below marginal cost.

The New South Wales government is moving towards competitive provision of third-party insurance for traffic accidents: registrants of motor vehicles will be required to purchase third-party insurance but will be free to choose among insurers. Programs have been developed in New South Wales to increase the private sector's involvement in financing and providing public housing.

Cash versus In-Kind Benefits

The provision of cash assistance rather than in-kind assistance changes the focus from the provider to the recipient; competition and choice are thereby facilitated.

Economists have traditionally preferred cash subsidies which are paid to individuals. Cash combines the virtues of flexibility (recipients can spend the assistance as they wish, thus maximising the value of the subsidy) and equity (it is available to all eligible persons). In contrast, not all of those who would like to take advantage of the in-kind services have access to them.

Why then is all assistance not provided in the form of cash? One reason is that people are concerned not only with the distribution of income and wealth in general but also to ensure that all individuals have access to certain services (for example, health and education services) that are regarded as being particularly important. Cash assistance may 'leak' to subsidise the consumption of goods and services that the government does not wish to encourage. In particular, left to themselves, parents may not always sufficiently consider the interests of their children in making spending decisions. Recipients may be more likely to become dependent on cash benefits than on non-cash benefits. Some donors may prefer their gifts to be used to finance in-kind benefits (e.g. facilities for handicapped people) rather than cash payments. Although cash assistance may maximise the value of the gift to the recipient, its value to the donor may be maximised if made in kind.

For these reasons society may decide, collectively, that some of the preferences of some of its members should be over-ridden. The government itself may provide a service either free or priced below marginal cost. Access to this service might be on the basis of need as determined by experts. But there are other methods. Governments could introduce earmarked cash payments (or vouchers) that could only be used to purchase a service, or a range of services, from approved providers. There would be some leakage of assistance from earmarked cash payments but this would be less than in the case of undirected payments. Leakage is likely to be particularly high if the voucher is a close substitute for cash (as was the case for food stamps in the US). Black markets may also develop that convert vouchers into cash.

Many of the advantages of replacing in-kind benefits by earmarked cash payments could be achieved through use of the 'brokerage model'. This form of earmarked cash payment is made not to the ultimate beneficiary or to his or her family but to a broker who acts on behalf of the ultimate beneficiary. The broker would contract with service deliverers for the provision of a range of services that was tailored to meet the needs of the beneficiary. Assessment of need would be made by experts and not through consumer choice; and the problems arising from 'information asymmetry' would be circumvented.

As is rightly emphasised by Laing (1991:23), it is important that brokers should be the agents of the beneficiary, not of governments or service deliverers. 'At this point it can simply be asserted that neither funding agencies nor supplier agencies nor brokerage agencies will operate as anything approaching perfect agents of consumers unless consumers or their own chosen agents are financially empowered to take purchasing decisions if they wish.'

Dr Roderick Deane of the New Zealand Electricity Commission has made the following comment in a recent publication (Deane, 1991:17):

> Given the concerns within New Zealand about the issue of 'privatising' social services, including not only the traditional areas such as health or education but also those seen to have been previously supplied by conventional SOEs [state-owned enterprises] such as subsidies for rural electricity users and subsidies for remote postal districts, it is surprising how little recognition has been given to the highly successful provision

> of social services by private sector organisations to groups within society who are normally regarded as highly dependent. Perhaps one of the leading examples is the New Zealand Society for the Intellectually Handicapped (the IHC) which as New Zealand's largest private sector voluntary organisation, with an annual budget of $NZ80 million and staff of over 2000, provides a wide array of services to the intellectually handicapped, ranging from preschool centres to workshop facilities, and from rural training centres to comprehensive residential services, all run on a user-pays basis but with a significant government subsidy.
>
> Two major reviews carried out in recent years by the Controller and Auditor-General, the most recent one having been published along with the Auditor-General's report on SOEs generally, not only concluded favourably with respect to the value for money aspects of the IHC services, but also compared them more than favourably with the costing of similar services by other organisations such as hospital boards. . . It is interesting to note that just before the last general election, the IHC volunteered to give up its direct government subsidies if the hospital boards and other agencies would also do the same and if the resultant pool of funds was utilised to increase benefits paid to intellectually handicapped people to enable them in turn to contract back to service provision agencies for services. The idea of this was to provide greater freedom of choice and more diversity of services. But the hospital boards were not prepared to support the proposals and neither was the government.
>
> In any event, organisations such as the IHC are interesting illustrations of the way in which social services can be successfully privatised. They also illustrate the validity of conceptually separating issues related to social service provision from those of privatisation.

The replacement of in-kind benefits by cash payments might be considered in a number of instances. Some concessions provided by Commonwealth and State governments (such as for pharmaceuticals, transport and rates) are income support in a slightly disguised form. Rates concessions, for example, are unlikely to have a major effect on decisions about home ownership by pensioners; their main effect is to make pensioners a little better off than they otherwise would have been. Considered as a form of income support, concessions have a number of disadvantages. Problems arise because of inequalities of access. People who are not home owners will not benefit from rates concessions, for example. Moreover the taxpayer may subsidise expenditure that is of little value to recipients or society because people will continue using a service that is provided to them free until the last unit has no value whatsoever. Against this, it may be that pensioners place a higher value on concessions than the cost to the government of providing them.

Many practical difficulties arise in wholly or partly replacing concessions by cash payments, but these may be capable of resolution. For example, the Commonwealth government in 1990 reduced the generosity of its pharmaceutical benefits for pensioners but increased pensions in compensation.

As noted in Chapter 2, the amount of housing assistance a family receives from government depends on its housing tenure. Home owners are most generously treated by government, public tenants less so, and private tenants are the least generously treated. Housing assistance could be made less tenure-specific through a uniform housing allowance for low-income renters of publicly and privately-owned accommodation similar to New Zealand's Accommodation Supplement (see p. 55 above). This allowance could be paid by the Department of Social Security to pensioners, beneficiaries and family-allowance recipients. The States could provide a supplementary rent rebate to some tenants if they so wished.

The replacement of in-kind benefits by undirected or earmarked cash benefits raises the problem of 'costs versus losers'. Because of inequalities of access, not all of those who are eligible to receive a subsidised service may be able to use it. If the subsidised service is to be replaced by a cash payment of a given amount to all who are eligible, either the total amount spent on the program must increase or some existing beneficiaries will be treated less generously than at present. One way of minimising this problem is to introduce a cash program on an optional basis. Those who do least well from the present program would move to the optional cash program, whose level of generosity would be set by the government. In these circumstances there is likely to be only a limited increase in government expenditure. Alternatively, the new program might be introduced only for those who become newly eligible for the benefit. The problem of 'costs versus losers' would also be eased to the extent that the replacement of in-kind benefits by cash payments permitted greater competition, and hence improved efficiency, in service delivery.

Private Alternatives to, or Supplements for, Government Provision

Thus far we have looked at how greater private effort could help the government to provide a social safety net more efficiently. Here we look at ways in which private effort can assist in achieving broader social objectives by replacing or supplementing government effort.

In many situations, private benefits and government-provided benefits are alternatives. For example, superannuation and other forms of private saving may be used to top up an age pension to an acceptable level. If sufficient savings are made, however, superannuation may completely replace the age pension in providing income in retirement. Sick pay from employers provides an alternative to the Commonwealth's sickness benefit. Payments resulting from the many kinds of insurance contracts provide an alternative to several forms of income support. Termination payments may supplement or replace unemployment benefit. The Commonwealth government's new child-support arrangements will increasingly supplement or replace the sole-parents pension.

In recent years, public policy has increased the importance of these private alternatives to, or supplements for, government provision. Absent parents will contribute more to the support of their children as a result of the child-support arrangements that were noted above. The Commonwealth government's superannuation changes in the late 1980s have signalled to people who want a standard of living in retirement in excess of that offered by the age pension that they will be expected to save for it.

Public and private payments may relate to one another in a number of ways. The first is the opting-out approach. This requires that there should be a user charge or levy on income specifically for financing certain services or benefits that are provided through the public sector. Those who choose to take advantage of the privately-provided service or benefit would not be required to make the financial contribution associated with the corresponding government service or benefit. This approach is naturally relevant for those government services that are charged for (e.g. public housing) and perhaps also for purpose-related levies such as the Medicare levy or the training levy. Indeed, a health-insurance arrangement which operated briefly in Australia during the mid–1970s embodied the opting-out approach. Alternatively, private payments may supplement or replace government payments. Much depends on means tests here. If means tests are tight, those with significant private means will not be able to claim the government benefit. If they are loose, substantial numbers of people will be able both to claim a government benefit and to enjoy a large private income as well. Conditions of eligibility (such as work or training requirements, where relevant) also help to draw the dividing line between public and private welfare.

Special means tests could take account of private payments that are close alternatives to their government counterparts. For example, British proposals for a child-support scheme apparently include a special tight means test that ensures that most of the benefit from increased payments of maintenance goes to taxpayers and not to the sole parent. The New Zealand government has adopted a similar approach. The Australian program includes a special means test for maintenance payments but a less stringent one than those proposed for Britain and for New Zealand.

Following a long period of easing, in recent years means tests have become tighter. There are some exceptions to this general rule: for example, pensioners and long-term unemployment beneficiaries who find work are now able to retain some benefits during their first few months in employment. In the light of concern about improving the efficiency of the Australian economy and reducing tax rates, this move towards tighter means tests will probably continue. Private provision would then take on a more important role and social-security payments will increasingly provide a basic safety net. This would seem to be in line with changes in community thinking. The superannuation industry once advocated abolition of the means test for aged pensioners. Now it argues that people should save enough to free them from dependence on the pension in retirement.

The amount of regulation that should be imposed on the private alternatives to government benefits is an important issue. Society (and perhaps those involved) may believe that immediate consumption is so attractive that, left to themselves, people will not save enough or purchase sufficient insurance, and should therefore be subject to compulsory savings or insurance programs. This argument has already been considered, and was found to be overstated. Worker's compensation and motor-vehicle third-party insurance are, however, compulsory; society is not prepared to trust individual judgments in those matters. Some degree of regulation is necessary even in, for example, superannuation to ensure that people have reliable information about the performance of fund managers and to clarify their rights to benefits. Too strict regulation, however, would limit the scope for innovation and competition. This has probably been true of the regulation of health insurance in the past.

Tax and Social-Security Treatment of Gifts of Capital and Income

So far, we have examined how greater private effort in welfare could help governments to achieve their objectives. A more far-reaching method of privatisation would be to allow private preferences to play a greater role. For example, the treatment of gifts of various kinds by the taxation and social-security legislation could be changed.

Because inheritance and gift duties have been abolished by the Commonwealth and State governments, gifts of capital do not in general affect the tax liability of either the donor or the recipient. Some gifts may, however, be deemed to be realisation of assets for capital-gains taxation. Income from the given asset will be taxed in the hands of the recipient.

Gifts of income are not, in general, recognised by the income-tax legislation. Such gifts neither reduce the taxable income of the giver nor increase that of the recipient. Taxation rebates are, however, available in certain circumstances (e.g. transfers to dependent spouses) and gifts to approved charities are deductible from taxable income. The taxation treatment of gifts of income has tightened considerably in recent years. Some gifts of income, such as maintenance payments, may reduce the recipient's entitlement to social-security benefits through the pensions means test.

The present taxation arrangements may unduly and undesirably discourage giving. Gifts both reduce reliance on social security and strengthen the ties between individuals. The taxation treatment of giving could be made more favourable by allowing people to transfer income-tax liabilities where giving takes the form of a legally enforceable covenant. A similar system existed in Britain before the 1988 Budget. This proposal would result in a net gain to the government budget where the marginal tax rate of the recipient (including, where relevant, the pensions means test) exceeds that of the giver. In other circumstances, there would be a net loss.

These arguments are particularly relevant to recent discussions about the taxation treatment of maintenance. Several taxation inquiries have recommended that maintenance payments should be treated as assessable taxable income for the recipient, but should be deductible from the taxable income of the donor. This recommendation has not been taken up by the Commonwealth government (see Commonwealth of Australia, Cabinet Sub-Committee on Maintenance, 1986:22). This is because of the effect on taxation revenue and because 'taxpayers paying maintenance could be treated more favourably than married taxpayers who spend a similar amount on the maintenance of their children'.

These objections may be overstated. It would only be necessary to provide tax relief to those married taxpayers who made a legally-enforceable agreement to transfer income to their spouses, children or other family members. One may, in any event, wonder whether it is a sound policy to ensure that maintenance will be resented and then to make it compulsory. An aim of social policy should be to create cheerful givers.

Gifts to charities are deductible from the donor's income tax. Some concern has been expressed in overseas countries that the lower marginal tax rates of recent years may reduce the value of tax relief for gifts and hence reduce the amount of giving. It is not clear that marginal tax rates have been reduced sufficiently in Australia to make this a serious problem. Some gifts to charity are made for altruistic reasons and may not be greatly influenced by taxation considerations.

The Goodman-Nicholas Proposal

In a recent CIS publication, Goodman and Nicholas (1990) put forward an ambitious plan for the privatisation of welfare. Their idea is as follows. Taxpayers would have their tax assessed in the normal way but they would be able to allocate a proportion of it either to the government for welfare spending or to one or more of a list of approved private charities for spending as the charities saw fit. This proposal combines a solution to the free-rider problem (since everyone would be required to pay tax) with competition in the financing and delivery of services. Goodman and Nicholas argue that charities are intrinsically more efficient than government organisations because they are more flexible and can make savings through, for example, the use of volunteers.

In my opinion, Goodman and Nicholas considerably overstate the case for their proposal. They are essentially drawing an analogy between competition in the market for goods and services and competition for charitable collections. Unfortunately, this analogy breaks down for a number of reasons. First, there is no equivalent to prices in the proposal for guiding resources to their best use. Because donations would be essentially costless to donors in Goodman and Nicholas' proposal, they might be given thoughtlessly. In particular, unpopular groups may be poorly provided for. To the extent that this happens, the government's responsibility for ensuring the provision of a social safety net would be abrogated. Second, it is not clear that the incentives for non-profit organisations such as charities to be efficient are very strong. There is, for example, no equivalent of the market for corporate control that tends to limit excesses by managers of public companies at the expense of shareholders. And it is not clear that charities face incentives to provide much information about their activities or that anyone has strong reasons to monitor their efficiency.

Of course, instances of egregious inefficiency would eventually come to the public's attention and would affect the amount that is given in donations. To this extent, the Goodman-Nicholas proposals would strengthen the incentives for charities to be efficient. But the sanctions against a climate of general, but mild, inefficiency may not be very strong. At the very least, considerable efforts would need to be made by governments to supervise the activities of charities.

The historical record in Australia shows that these concerns may be well-founded. In the 19th century, welfare in Australia was provided largely by charities. Royal Commissions in New South Wales during the 1890s provided evidence of inefficiency and financial irregularity in charitable organisations. More seriously, Royal Commissions in Victoria provided evidence of abuse of residents of charitable institutions (see Chapter 2 for further discussion).

The objections to an alternative proposal by Goodman and Nicholas are less strong. Under this version only a small proportion of the tax bill would be available for ear-marking to charitable organisations. Governments could then adjust their own expenditures to ensure that unpopular groups were provided for. The main advantage of this proposal would be to increase, to a minor extent, the sense of involvement of taxpayers with the welfare system.

This is not, as it happens, a new idea. Goodin (1985:163) reports as follows:

> Some of the most promising collective schemes do, in fact, leave lots for individuals to do. In order to make individuals feel psychologically a part of the foreign aid program, Hirschman and Bird (1968, p.15), for example, propose that individual taxpayers should be allowed to elect to use a limited portion of their income-tax obligation for contributions to one of several (multi-lateral) World Development funds, rather like the tax check-off now operating to finance the Presidential campaign fund in the United States.

Summary and Conclusions

A number of ways in which private effort could play a greater part in financing and delivering income support and welfare services have been discussed in this Chapter. A distinction was drawn between proposals that would permit a greater degree of private effort in the service of government objectives and those that would allow the preferences of private donors to play a greater part in determining the size and nature of the welfare program.

Government objectives could be achieved more efficiently through greater use of private effort by:

- introducing contracts and competitive tendering (in, for example, training and rehabilitation programs, children's services, services for disadvantaged communities);
- extending the scope for competition to include commercial as well as government and non-profit making organisations;
- replacing, perhaps on an optional basis, some in-kind benefits by earmarked or undirected cash payments (some pensioner concessions, housing assistance);
- introducing the brokerage model where earmarked cash payments are made to brokers who develop tailor-made packages of services for their clients (services for the aged and disabled);
- enabling those with adequate private insurance to choose not to receive the equivalent government benefit and to opt not to pay the associated financing measures (e.g. health insurance);
- phasing in tighter means tests so that those with adequate financial means are less able to claim government benefits (income-support payments);
- establishing special means tests for those private payments that are close substitutes for government benefits (e.g. maintenance);
- reviewing non-income eligibility criteria such as training and work requirements;
- developing regulatory regimes (e.g. for health insurance, superannuation, workers' compensation, motor-vehicle third-party insurance) that do not unduly restrict the scope for competition.

The preferences of private individuals could play a greater part in determining the size and nature of the welfare program by:

- re-examining the tax and social-security treatment of gifts of capital and income;

- introducing the Goodman-Nicholas proposal to allow taxpayers to allocate a proportion of their tax bill to one or more members of a list of approved private charities.

Greater acceptance of the use of prices (or user charges) to direct resources to their most productive uses in the welfare sector would make it easier to implement these ideas. Distributional objectives could then be met by undirected or earmarked cash payments either to the intended beneficiary of the program or to someone who could be trusted to act on his or her behalf.

The prospects for introducing these proposals are discussed in Chapter 7.

Chapter 7

The Prospects for a Greater Role for Private Welfare

However great the potential of private effort, it may not be realised. Although greater private effort may help society better to meet its social objectives, it would tend to disadvantage those who are working in government-provided services. They could be expected to oppose proposals for greater competition and private effort. These circumstances are met in many areas of economic and social policy. It would be useful, not least for liberals, to develop an understanding of the circumstances in which policies that favour broad groups (such as taxpayers) are likely to be preferred to policies that benefit smaller groups (such as those people who work in the social services).

The Changing Pattern of Expenditure

The past decade has been a mixed one for the control of social expenditure. As was noted in Chapter 4, policy changes have limited the proportion of older people who receive the age pension. Family assistance has been redirected towards low-income families. The number of invalid and sole-parent pensioners has continued to increase. The number of unemployment beneficiaries has varied with economic conditions. Government expenditure on services for children and the aged has grown rapidly.

This changing pattern of expenditure has been a consequence of: the development of political priorities (in particular the intention to concentrate government assistance on the most needy); changes in demography and values; and the responses of individuals to the pattern of incentives generated by government programs and the taxes that finance them. Governments may continue to direct expenditure according to these priorities. But welfare spending is likely to be severely limited in the future by economic circumstances and the adverse consequences of government welfare programs. Greater competition and private effort in welfare have much to offer in enabling governments to achieve their welfare objectives at least cost. But to what extent are they likely to be adopted?

There can be little doubt that greater competition and private effort in welfare would be controversial. For example, according to the Evatt Research Centre's recent publication *State of Siege:*

> The problem here is that privatisation throws the best parts and endeavours of the public sector out with the bathwater. Clearly there is a great merit in ensuring the most effective use of public revenue, questioning the strategy of some public service endeavours and in suggesting reforms which will result in increased efficiencies. This point gets lost, however, in the narrow and exclusive reference point provided by a theoretical model of the market place. The philosophy of privatisation ignores the positive role and methods of the public sector in combating social inequality and creating otherwise lost economic and social opportunities. Due to this oversight, action taken to privatise the public sector has not secured freedom, liberty and enterprise for the majority. In reality, the rhetoric of privatisation often functions as a blunt ideological instrument wielded by those not fully versed in the subtleties and complexities of government. (Evatt Research Centre, 1989:79)

These criticisms to some extent miss the point. Private effort and competition in the financing and delivery of welfare services may enable more opportunities to be created than was previously the case and greater effectiveness in combating social inequality. The issue is the best way of meeting government objectives.

Income support, welfare services and housing can usefully be considered to be examples of highly-regulated industries. Entry into, and exit from, these industries are controlled and some parts of them are reserved for government monopoly. Many pricing and investment decisions in these industries are taken by government. It is noteworthy that deregulation in countries such as the United States, the United Kingdom, New Zealand and Australia has not included the welfare state to any great extent. The advocacy by economists of pro-competitive policies in welfare, such as vouchers, has not had any great practical effect. To understand why this might be so, the literature on the reasons for regulation is reviewed briefly below. My particular concern is to gain an understanding of the circumstances in which it becomes acceptable to open a highly regulated industry to competitive pressures.

Theories of Regulation and Deregulation

Traditionally, regulation has been viewed as a response to market failure, such as the presence of natural monopolies in areas like electricity distribution and water supply. The inability of the market, unaided, to achieve society's equity objectives might be considered to be another example of market failure justifying welfare expenditures but not all examples of regulation can plausibly be justified as responses to market failure.

In recent years another theory of regulation has been developed. This is sometimes rather grandly called the 'economic theory of regulation' (Peltzman, 1989). Its proponents suggest that regulation results from the attempt by interest groups to use the coercive powers of the state to obtain a more favourable distribution of income. Early examples of this *genre* (e.g. Stigler, 1971) argued that the regulatory authorities tend to be captured by producer interests (labour and capital) in the regulated industry. Because producer groups are typically smaller than consumer groups, they have (in per capita terms) a greater incentive to influence the political process in their favour and find it easier to do so. Producer groups tend to have informational and organisational advantages over other groups. But although the 'capture theory' is part of the story, it is not the whole story. For example, the existence of cross-subsidies in the pricing structure of public enterprises and regulated private firms suggests that some consumer interests, as well as producer interests, may benefit from regulation.

More recent work on the economic theory of regulation (e.g. Peltzman, 1976, and Becker, 1983) takes a broader view of the problem. Politicians, it is argued, have to build coalitions of support to gain office and to remain in office. This requires them to strike a balance between the interests of broadly based groups, such as taxpayers and consumers in general, and narrowly based groups such as employees and particular consumers. As noted earlier, smaller groups have certain advantages over larger ones. But the winning coalition usually includes groups of consumers as well as producers. Because the political influence that a group of consumers can muster is not related to the marginal cost of providing them with the service, the price structure of a regulated private or public enterprise is likely to include cross-subsidies from low-cost consumers to high-cost consumers (e.g. those living in rural areas). There may be other cross-subsidies as well.

Economic theory suggests that a misallocation of resources occurs where prices diverge from marginal cost. The consequent loss of income will increase more than proportionately as the difference between price and marginal cost increases. The losers from regulation can be expected to organise to oppose it and to do so with increasing vigour as their losses increase. They will be at a disadvantage (compared with narrowly-focused groups) in terms of information and organisation. But if the costs imposed by regulation become too high, the opponents of regulation will come to form part of the dominant coalition. Good economics (i.e. promotion of mass interests as opposed to sectional interests) is sometimes, but not always, good politics.

The economic theory of regulation suggests that deregulation may occur in certain circumstances. A change in technology or in demand conditions in the relevant markets may well lead to a change in the politically optimal structure of regulation. Moreover, the side effects of regulation can reduce the amount of benefit that certain groups obtain from it. Once the benefits to the dominant coalition become sufficiently small, deregulation may occur. For example, non-bank financial institutions grew in importance in Australia during the 1970s as a consequence of the regulation of bank interest rates. This eventually led the banks to favour deregulation. Deregulation, however, is not the only possible response to these circumstances since regulation could have been expanded to encompass the alternative services that sprang up in the gaps between the regulations.

There has been a good deal of debate in Australia and the United States about the extent to which these ideas can explain the deregulation that has taken place in recent years. In my view, the economic theory has some explanatory power but does not provide the full explanation. As noted, many industries in the United States and in Australia have not been deregulated. Peltzman (1989) found that most episodes of deregulation in the United States were not inconsistent with the economic theory of regulation. But the economic theory does not, in Peltzman's view, explain why deregulation was the chosen response to changed circumstances rather than, for example, some form of tighter regulation. In Australia, Harper (1987) and Dwyer and Forsyth (1990) have discussed banking and airline regulation respectively with reference to the economic theory.

The Demand for Economic Justice

The views of the general public about economic justice are another important factor. This is not to deny the validity of the economic theory. We might think that the task of a policymaker is to try to organise a winning coalition of interests subject not only to the constraints imposed by demand and supply conditions (which determine the costs associated with the distortions induced by regulation) but also the views of the public about the fairness of the distributional changes that would result from changes in regulatory regimes. This augmented theory seems to explain why some markets have been deregulated but not health, pensions and so on. In these areas there has been concern about the distributional consequences of changed regulation. It may also explain why deregulation of the banks and domestic aviation was preferred to other possible options.

The argument that interest-rate controls were unfair because they resulted in low rates of interest for small savers was influential at the time of deregulation. The progress of airline deregulation was helped by the realisation that no social objectives were being advanced by the previous regulatory arrangements and the public believed it unfair that travellers should not have access to cheap fares. The acceptability of tariff reductions in recent years may owe something to the view that tariffs had not been successful in generating industrial development and employment, and that it was therefore unfair to deny Australians access to cheap imports. The efforts of economists and others in stressing the costs of protection have undoubtedly helped. But the public may sometimes favour tighter regulation of markets if the distributional outcome would otherwise be inconsistent with its views about economic justice.

Some readers may feel that popular views about fairness are irrational relics from an earlier, tribal stage of society and should play only a minor part in ordering the affairs of a well-organised community. They may be right but, even so, we have to deal with people as we find them. The importance of fairness considerations in determining policy choices can be illustrated each day in government departments.

Fairness is an imprecise concept but a number of attempts have been made to make it more precise. Based on his experience in public utility regulation, Edward Zajac (1985) has put forward the following six propositions concerning economic justice:

1. Every individual has basic economic rights to adequate food, shelter, heat, clothing, health care, education and basic utility services. Denial of basic economic rights is considered unjust.
2. Equal treatment of individuals is a just basis for policy, especially where common measurements, such as dollars or time, of individual fairness or sacrifice are at hand. Unequal treatment of individuals is considered unjust.
3. The beneficial retention of a status quo is considered a right whose removal is considered unjust.
4. Society is expected to insure individuals against economic loss because of economic changes. Failure to insure is considered unfair.

5. The existence of numerous and significant economic inefficiencies is considered unjust, especially if their existence is seen as conferring benefits on special-interest groups who oppose their removal.
6. The fewer the substitutes for a regulated firm's output, and the more the output is considered an economic right, the more the public expects to exert control over the firm. Denial of control is considered unjust.

These propositions were developed in order to help explain the regulation of public utilities in the United States. But they are widely applicable. They encapsulate feelings that commonly arise when policy changes are being considered. The propositions may conflict (e.g. 3 and 5) and sorting out such conflicts is a matter for individual judgment, case by case. The second principle might be better worded to suggest that it is considered unfair to treat people in similar situations differently. This has been, for example, a major reason for the expansion of welfare programs in recent years.

Fairness and the Regulation of Welfare Services

The next step is to consider the implications of the preceding discussion for welfare services, where fairness considerations are likely to be even more important than they are for public-utility regulation. In which circumstances are changes in the regulation of welfare services likely to occur and which changes are most likely to be acceptable on grounds of fairness? I am not able to make precise forecasts about the future but hope to make some general points about the direction in which we seem to be heading. If readers do not feel comfortable about some or all of these trends, they may wish to consider whether and how the trends are capable of reversal.

Concern about Australia's relatively poor economic performance will probably continue over the next few years. This, and continuing unease about high marginal tax rates, will encourage investigation into new and better ways of achieving welfare objectives. Policymakers may continue to emphasise mass interests (such as taxpayers and consumers) at the expense of specific interests to a greater extent than is traditional in Australia. The growing education and sophistication of the population may lead them to demand a more diverse range of welfare services than governments have traditionally provided. Advances in information storage and processing have made practical the monitoring and enforcement of contractual arrangements far more widely than was previously possible.

The general climate therefore favours change in the way that welfare services are provided. But in this area above all others the changes that are likely to occur are those that are consistent with the public's ideas about fairness. The easiest changes to introduce are those that are better ways of doing what we do now. Provided that concerns about service quality can be addressed successfully, I believe that we are likely to see greater use of contracting, competitive tendering and so on. For example, the Commonwealth and New South Wales governments now seem to favour the introduction of greater competition in the provision of vocational training. Opposition to these moves is likely to come from public employees but may not be influential for a number of reasons.

Interest is increasing in the private provision, to those who can afford it, of more lavish welfare services than governments choose to provide. Retirement incomes will increasingly be provided through superannuation. The private provision of accommodation and services for the aged seems to be a growing industry, at least in certain parts of Sydney. Possibilities for developing a better relationship between Medicare and private-health insurance are now being investigated. And so on. The best regulation of these industries requires further attention.

The replacement of in-kind benefits by cash will give rise to concerns about the ability of the recipients to spend the money wisely. Even so, I would expect to see some such changes. This is particularly likely where in-kind benefits can be shown to be inequitable (because many people have difficulty in gaining access to them) or where recipients are the best judges of how the money should be spent. There may also be greater use of the brokerage model in which payments are made to brokers who purchase services on behalf of their clients.

I suspect that the general public would consider that proposals (such as the one by Goodman and Nicholas) to replace the welfare safety net by donations to charity are unfair. This is because we cannot be certain that all disadvantaged people or groups would find someone to help them. There may be some initiatives to allow the preferences of private individuals greater scope in determining the size and scope of welfare activity, for example through a more favourable treatment of certain gifts by the income-tax legislation, or by introducing the less far-reaching alternative proposal by Goodman and Nicholas. But these initiatives are unlikely to be very important.

In summary, I believe that we are likely to see the greater use of private effort to achieve government welfare objectives.

A Contract and Subsidiarity State?

Christopher Hood has drawn a distinction between the public-bureaucracy state and the contract or subsidiarity state. The public-bureaucracy state is the 'embodiment of a belief that the best way to provide public services is through permanent career professionals working in an integrated government-wide service within monopoly public bureaucracies under the direct oversight of ministers and financed from general tax funds'. In contrast, the contract state 'is a shorthand term for a preference for doing government business by performance contracting — or at least on a quasi-contractual basis — rather than by public bureaucracies operating under day-to-day political oversight' (1989:81). The subsidiarity doctrine, a less liberal approach, is associated with the position taken by the Roman Catholic Church on welfare-state questions. This doctrine 'says that public services (or aspects of services) which do not directly involve the wielding of public power should be performed by independent and private organisations wherever that is compatible with effective provision, and that they should be performed at the lowest level (in geographical or communal terms) which is compatible with effective provision' (1989:83).

Of course, the extent to which welfare services can be provided through contractual arrangements is limited. Contractual relationships are least likely to be satisfactory: where there are few potential contractors (e.g. because information and expertise is limited); where suppliers may exploit any monopoly powers they possess; and where specifying the contract and monitoring performance is difficult because of uncertainty about what is required of the contractor or the contingencies that should be provided for in the contract. In Hood's view, the impediments to the greater use of contractors are fewer in the social area than in other areas of government activity. The use of public servants to deliver welfare services is likely to fall further. Although there are exceptions (e.g. the professionalisation of the Home Care Service in New South Wales) this forecast seems to be consistent with the general trend of recent developments.

Hood's analysis, therefore, tends to support our earlier argument that private effort to achieve government welfare objectives is likely to expand in Australia. Economic and social changes may lead us to emphasise the contract aspect of the alternative to the public-bureaucracy state at the expense of the subsidiarity aspect.

In conclusion, the likely outlook is mixed. Competition and private-sector delivery of services will probably increase in areas such as income support, welfare services and housing. Depending on the circumstances, these gains in efficiency may permit tax cuts — or an even more extensive welfare state. The number of public servants administering the welfare state may stabilise or fall. But we are unlikely to see the boundaries of the state rolled back in any fundamental sense. Some issues seem likely to remain controversial: for example, the extent to which profit-making organisations should be allowed to compete for the right to provide welfare-state services, the best mix of cash and in-kind benefits, means tests, and the extent of regulation of superannuation and the other private supplements to the offerings of the welfare state. These may be the areas where further analysis is most profitable.

Chapter 8

Concluding Thoughts

In *The Constitution of Liberty*, F. A. Hayek argues that it

> is essential that we become clearly aware of the line which separates a state of affairs in which the community accepts the duty of preventing destitution and providing a minimum level of welfare from that in which it assumes the power to determine the 'just' position of everybody and allocates to each what it thinks he deserves. Freedom is critically threatened where the government is given exclusive powers to provide certain services — powers which, in order to achieve its purpose, it must use for the discretionary coercion of individuals. (Hayek, 1960:289–90)

Hayek might therefore agree with two conclusions of the present study: that the strongest case for state involvement can be made for the minimum welfare state and that competition in the provision of these services is to be encouraged.

On the minimum welfare state, Hayek has this to say :

> What we know now as public assistance or relief, which in various forms is provided in all countries, is merely the old poor law adapted to modern conditions. The necessity of some such arrangement in an industrial society is unquestioned — be it only in the interest of those who require protection against acts of desperation on the part of the needy.
>
> It is probably inevitable that this relief should not long be confined to those who themselves have not been able to provide against such needs (the 'deserving poor', as they used to be called) and that the amount of relief now given in a comparatively wealthy society should be more than is absolutely necessary to keep alive and in health. We must also expect that the availability of this assistance will induce some to neglect such provision against emergencies as they would have been able to make on their own. In seems only logical, then, that those who will have a claim to assistance in circumstances for which they could have made provision should be required to make such provision themselves. . .
>
> Up to this point the justification for the whole apparatus of

> 'social security' can probably be accepted by the most consistent defenders of liberty. Though many may think it unwise to go so far, it cannot be said that this would be in conflict with the principles we have stated. Such a program as has been described would involve some coercion, but only coercion intended to forestall greater coercion of the individual in the interests of others; and the argument for it rests as much on the desire of individuals to protect themselves against the consequences of the extreme misery of their fellows as on any wish to provide more effectively for their own needs. (1960:285–6)

Hayek's argument is for compulsory provision for those in need, not for monopoly provision. Social insurance, however, has almost always involved compulsory membership of a unitary organisation controlled by the state. As a consequence, the welfare state has become a way of socialising the income distribution.

> We have seen how the practice of providing out of the public purse for those in great want, in combination with that of compelling people to provide against these wants so that they should not become a burden on the rest, have in the end produced almost everywhere a third and different system, under which people in certain circumstances, such as sickness or old age, are provided for, irrespective of want and irrespective of whether or not they have made provisions for themselves. Under this system all are provided with that standard of welfare which it is thought they should enjoy, irrespective of what they can do for themselves, what personal contributions they have made, or what further contribution they are still capable of making. (1960:292)

What of the future of the welfare state? According to Hayek,

> There perhaps exists no insuperable obstacle to a gradual transformation of the sickness and unemployment allowance systems into systems of true insurance under which the individuals pay for benefits offered by competing institutions. It is much more difficult to see how it will ever be possible to abandon a system of provision for the aged under which each generation, by paying for the needs of the preceding one, acquires a similar claim to the support of the next. It would almost seem as if such a system, once introduced, would have to be continued in perpetuity or allowed to collapse entirely. The introduction of such a system therefore puts a strait jacket on evolution and places on society a steadily growing burden

> from which it will in all probability again and again attempt to extricate itself by inflation. Neither this outlet, however, nor a deliberate default on obligation already incurred can provide the basis for a decent society. . .
>
> Though we may have speeded up a little the conquest of want, disease, ignorance, squalor, and idleness, we may in the future do worse even in that struggle when the chief dangers will come from inflation, paralyzing taxation, coercive labor unions, an ever increasing dominance of government in education, and a social service bureaucracy with far-reaching arbitrary powers — dangers from which the individual cannot escape by his own efforts and which the momentum of the overextended machinery of government is likely to increase rather than mitigate. (1960:304–5)

The economic experience of the past 30 years underlines the prescience of Hayek's warnings. But it is Australia's peculiar good fortune that, unlike most similar countries, we have not 'advanced' from income support to social insurance. Pensions and benefits are paid in Australia subject to a test of need. We do not really believe in our own system: the means test is generous enough to allow 80 per cent of the relevant age group to receive the age pension or equivalent and for 60 per cent to receive the maximum rate of pension. And we attempt to socialise the distribution of income by other means; for example, through the regulation of superannuation. Because high inflation and high taxation have reduced both the current retired generation's savings and the current working generation's ability to save, the move towards a more genuinely needs-based system of government welfare is likely to be a gradual one. But it is my hope that intelligent use of the intellectual capital embodied in Australia's history of needs-based welfare and private provision of welfare will enable us to avoid the worst of the dangers pointed out by Hayek while continuing to meet the most important of the community's aspirations for economic justice.

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