TARGET30—TAX-WELFARE CHURN AND THE AUSTRALIAN WELFARE STATE

Andrew Baker

THE CENTRE FOR
INDEPENDENT
STUDIES

TARGET30—Tax-Welfare Churn and the Australian Welfare State

Andrew Baker

THE CENTRE FOR INDEPENDENT STUDIES

T30.02

CIS TARGET30 publications

TARGET30

T30.01 Simon Cowan, *Towards smaller government and future prosperity* (2013).

CIS related publications

Policy Monographs

PM100 John Humphreys, *Ending the Churn: A Tax/Welfare Swap* (2009).

Issues Analysis

IA57 Peter Saunders, *The $85 Billion Tax/Welfare Churn* (2005).

ACKNOWLEDGEMENT

The author would like to thank Peter Saunders, Simon Cowan, Jeremy Sammut, Ben Herscovitch and Alex Philipatos for their comments on an early draft. The author takes full responsibility for any errors or omissions.

Contents

Executive Summary

- **In 2010–11, Australia's welfare state, which includes health, education and income support payments, accounted for approximately $316 billion in government expenditure and 65% of total government expenditure.**
- By way of comparison, Australia's three levels of government received $358 billion in tax revenue in 2010–11, of which $138 billion was received through income tax payments.
- **Of the $316 billion spending on the welfare state, approximately half, or $158 billion, can be attributed to tax-welfare churn.**
- Tax-welfare churn, the process of levying taxes on people and then returning those taxes to the same people in the form of income support payments and welfare services, simultaneously or over the course of an individual's lifetime, continues to be a problem in Australia.
- Churn imposes a number of social and economic costs such as high taxes, administration costs, inefficiency, rent-seeking, paternalism, and welfare dependency.
- While Australia has relatively low levels of churn when compared to other developed countries, this does not mean governments and policymakers should ignore the issue.
- **ABS data show the Australian welfare state provides a 'benefit tsunami' once someone retires because the welfare benefits that elderly individuals receive substantially exceed their tax contributions after they retire.**
- Governments have recently committed to further expansion of the welfare state via increased pension payments, the National Disability Insurance Scheme (NDIS), and school education reforms—all of which exacerbate the financial crisis we are heading towards.
- **When combined with the fiscal pressures of an ageing population and expected lower tax revenue growth, it is clear the Australian welfare state is unsustainable on current trends.**
- There are a number of possible reforms that, in addition to being worthy policy changes in their own right, would have the additional benefit of reducing tax-welfare churn.
- For example, Australia's system of retirement savings is in dire need of reform. Aligning and increasing the preservation and age pension eligibility ages, combined with a requirement to use superannuation savings to purchase an annuity, will go far to reducing lifetime tax-welfare churn, welfare dependence, and future fiscal pressures.
- There are numerous possible reforms to income support payments (including Family Tax Benefits and the Disability Support Pension), education and health that can reduce churn. This report outlines a selection of possible reforms.
- Finally, this report briefly outlines the concept of a 'personal savings and loan account,' a tax-effective savings vehicle that would allow people to receive welfare benefits in the form of income contingent loans and make tax-free contributions to cover income support, health and education expenses.

Introduction

In March 2013, The Centre for Independent Studies launched the TARGET30 campaign with the combined objective of promoting the benefits of smaller government and reducing the size of government from 35% of GDP to less than 30%. Policies aimed at reining in Australia's welfare state, which costs around $316 billion a year and accounts for around 65% of government spending, must be addressed as part of any serious attempt at reducing the size of government.

At $316 billion a year, Australia's welfare state does not come cheap. While some of this expenditure can be explained through government's role as 'Robin Hood'—taxing the rich to give to the poor—a significant portion of the welfare state involves tax-welfare churn, where the state taxes middle and high income earners and then returns those taxes in the form of welfare benefits and services to the same people, usually with conditions and requirements attached.

This churn sometimes happens simultaneously, as income taxes are paid to government and then returned in the form of transfer payments like Family Tax Benefits, Child Care Benefits, and education services. At other times, this churn occurs over the course of someone's life—taxes paid during an individual's working life are returned as the age pension, subsidised health care, and supported accommodation upon retirement.

Although churn may seem fairly benign, it results in substantial administration costs, compliance costs, and widespread inefficiency, which then lead to higher taxes, rent-seeking, government paternalism, and welfare dependency.

Although churn may seem fairly benign, it results in substantial administration costs, compliance costs, and widespread inefficiency, which then lead to higher taxes, rent-seeking, government paternalism, and welfare dependency.

A government taking money off citizens with one hand and then returning that money with the other is absurd; however, there are other problems with churn and the welfare state more generally. This report explores the nature of tax-welfare churn in Australia and suggests targeted and pragmatic policy reforms to reduce this churn.

Is churn a problem?

So is churn a problem in Australia? The economic costs of churn in Australia are relatively small compared to similar countries. As Professor Peter Whiteford, a vocal critic of churn, points out, because of Australia's relatively tough means-testing requirements for income support payments, the rate of churn in Australia is the lowest in the OECD by a substantial margin.[1]

However, this does not mean churn is not a problem in Australia. Tax-welfare churn leads to economic costs—for example, administration and compliance costs, a higher tax burden, and higher effective marginal tax rates (EMTRs) and non-economic costs including increased welfare dependency, government paternalism and patronage, and the creation of a complex tax-transfer system.[2]

Of the $192.7 billion the Commonwealth will spend on health, social security and welfare in 2012–13, approximately $7 billion will be spent on general administration.[3] The Australian Taxation Office (ATO) spends about $3.2 billion on its tax collection efforts to pay for the welfare state. While $10 billion may seem a relatively modest administrative cost when compared to the overall Commonwealth expenditure on the welfare state, this $10 billion pays for the direct employment of nearly 70,000 federal public servants who administer the churn.[4] And these figures do not include the additional administration costs of state governments or private sector workers such as accountants, advisers and lawyers advising people on dealing with the tax and welfare system.[5]

Higher levels of churn mean higher levels of taxation. This can lead to higher EMTRs for some people: As they earn more from working, they begin to pay income tax and their welfare payments are tapered by around 50 cents in the dollar after they earn more than an income threshold, which is currently $62 a fortnight for Newstart Allowance. Working in tandem, income taxes plus taper rates can push EMTRs well north of 50 cents for every dollar earned from work.[6] This reduces the incentive for some people to move off welfare and into work, and therefore, continuing their dependence on welfare and creating a 'poverty trap.' Minimising churn through reduced taxes or greater use of tax credits will minimise EMTRs, and therefore, the disincentive for moving off welfare and into work.

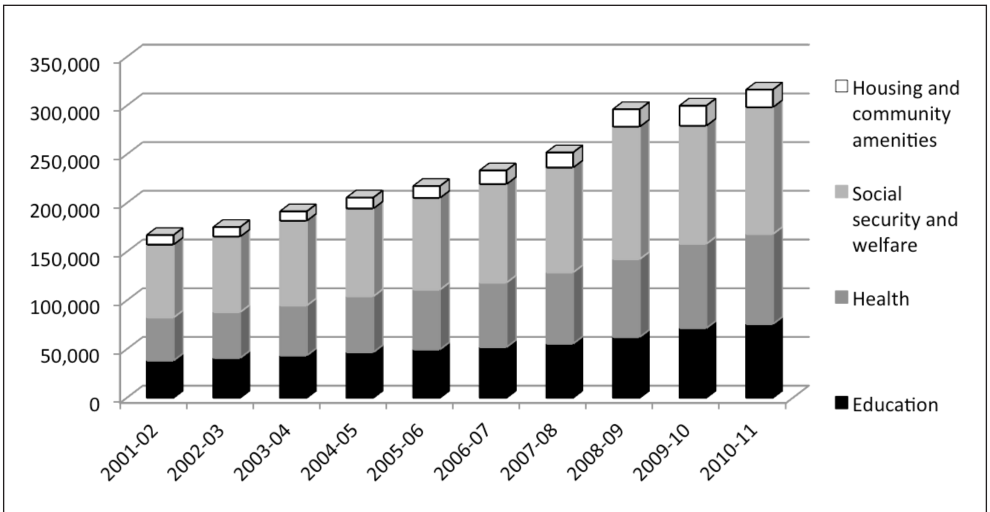
The paternalistic aspect of churn—where government taxes and then returns those taxes with strings attached through welfare services such as subsidised doctor's appointments, hospital treatments, and schooling—also undermines the capacity of individuals to look after their own affairs. Minimising churn through reduced welfare expenditure and income taxes would empower people and allow them to control how they spend their money. For a more in depth discussion of tax-welfare churn and why it is a problem, see the CIS publication, *The Government Giveth and the Government Taketh Away* (2007).[7]

How big is Australia's welfare state now?

In 2010–11, Australia's federal, state and local governments spent $316 billion on social security, health, education, and housing/ community amenities.

Broadly, the welfare state can be broken down into four large policy areas: social security, health, education, and housing/community amenities. In 2010–11, Australia's federal, state and local governments spent $316 billion on these four areas.[8] The Commonwealth, given its responsibility for funding income support payments, is responsible for around $200 billion of the spending; the states, through primary and secondary education, as well as hospitals, account for approximately $100 billion; and local governments account for the remainder.

Figure 1: Growth in the Australian welfare state, 2001–02 to 2010–11 ($ million)



Source: ABS (Australian Bureau of Statistics), *Government Finance Statistics, Australia, 2010–11*, Cat No. 5512.0 (17 April 2012). See Table 939.

The welfare state can be conceptually divided into two parts. The first part includes income support payments such as the Age Pension, Disability Support Pension, Family Tax Benefits, and unemployment benefits like Newstart Allowance. The second part comprises subsidised services such as public schools, income contingent loans for higher education, subsidised health care (through Medicare and the Pharmaceutical Benefits Scheme), and public housing.

Table 1: Government spending on the welfare state, 2010–11 ($ billion)

Education	75.6
Health	92.3
Social security and welfare	130.1
Housing and community amenities	18.1
TOTAL	316.3

Source: ABS (Australian Bureau of Statistics), *Government Finance Statistics, Australia, 2010–11*, Cat No. 5512.0 (17 April 2012). See Table 939.

In 2010–11, Australia's $316 billion a year welfare state accounted for more than 65% of all government expenditure, 70% of the $448 billion in all government revenue, and more than 88% of the $358 billion in all government taxation revenue.[9] The $90 billion difference between the general revenue and taxation revenue figures is explained by sales of goods and services, dividends and interest income.[10]

In 2010–11, Australia's $316 billion a year welfare state accounted for more than 65% of all government expenditure, 70% of the $448 billion in all government revenue, and more than 88% of the $358 billion in all government taxation revenue.

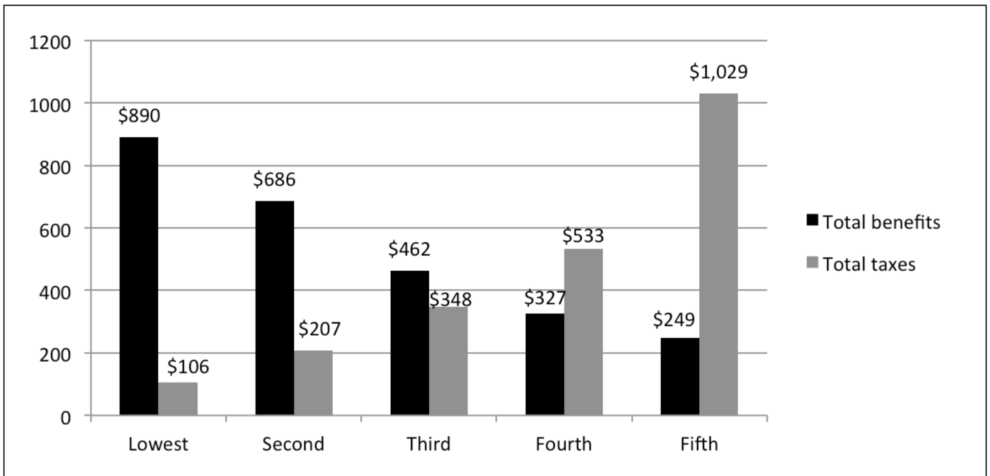
Box 1: How much welfare spending is churn?

Peter Saunders calculated that at least half ($85 billion) of all welfare expenditure ($174 billion) consisted of churn in 2003–04.[11] Similarly, John Humphreys estimated churn to be 50% to 56% of welfare state expenditure, and that in 2007–08, total churn accounted for between $127 billion and $142 billion of government expenditure.[12] Taking 50% of the $316 billion in 2010–11 welfare state expenditure as churn, tax-welfare churn amounted to $158 billion in government expenditure.

Who pays? Who receives?

Australia's welfare system is notable for its tight means testing of welfare payments and highly progressive tax system. Those on low incomes pay little or no income tax and receive significant welfare benefits, while those on high incomes pay much more income tax and receive substantially less in benefits. This leads to high levels of tax-welfare churn at the middle of the income spectrum.

Figure 2: Total benefits and taxes, average weekly value ($) by income quintile, 2009–10



Source: ABS, *Government Benefits, Taxes, and Household Income, Australia 2009–10*, Cat. No. 6537.

As outlined in Figure 2 and Table 2, the bottom 20% of households by income receive government-funded benefits worth around $890 but pay relatively little tax; the inverse is true for the top 20% of households because they receive relatively few benefits and pay substantial taxes. The disparity between highest and lowest household income quintiles in terms of tax paid and benefits received should not come as a surprise; what is of greater concern is the tax-welfare churn in the second, third, fourth and fifth income quintiles.

The third income quintile is of particular interest: the median Australian household receives more in benefits each week ($103 in welfare payments and $359 in welfare-in-kind) than it pays in total taxes each week ($348). Family Tax Benefits account for more than a third of the cash transfers ($36 per week), and the Age Pension accounts for more than 20% of these receipts ($24 per week). Of the $359 of welfare-in-kind, $166 is in the form of health care benefits such as hospital stays or GP visits, and $147 is for education benefits ($107 on school education and $32 on tertiary education). The remainder comes from child care assistance and other social security and welfare supports.

The tax-transfer system at the household income level shows that many households pay substantial taxes, only to receive some, if not all, of that money back in the form of welfare services.

Table 2: Equivalised private household income quintile, 2009–10, average weekly value ($)

	Lowest	Second	Third	Fourth	Fifth
Private income	170	810	1,447	2,090	3,650
Total social assistance benefits in cash	435	251	103	35	15
Total selected social transfers in kind	455	435	359	292	234
Total income	1,060	1,496	1,909	2,417	3,899
Income taxes	1	58	167	317	756
Production taxes	105	149	181	216	273
Total taxes	106	207	348	533	1,029
Final income	954	1,289	1,561	1,884	2,870
Total benefits allocated	890	686	462	327	249
Total taxes allocated	106	207	348	533	1,029
Net benefits allocated	784	478	114	-206	-780

Source: ABS, *Government Benefits, Taxes, and Household Income, Australia 2009–10*, Cat. No. 6537.

The tax-transfer system at the household income level shows that many households pay substantial taxes, only to receive some, if not all, of that money back in the form of welfare services. While it is clear that churn exists, and that most of it comes from welfare-in-kind rather than welfare payments, Table 2 only presents a vague picture of lifetime churn.[13]

For example, education only accounts for 11% of the total value of benefits received by those in the lowest income quintile. However, for those in the second income quintile it accounts for 22%; for those in the third, fourth and fifth quintiles, it accounts for around 33%. This can be partially explained by the many age pensioners in the lowest quintile and not having children going to school or university living in their household, which would reduce the education benefits they receive. Additionally, children in families with higher incomes are more likely to stay in school for longer and receive additional government-funded benefits from subsidised tertiary education, increasing the volume of government benefits they receive.

When and where is the churn?

As Table 3 makes clear, one-parent families with dependent children are significant beneficiaries of the welfare state, receiving net benefits with an average weekly value of $732 (largely comprising Parenting Payment, Family Tax Benefits, and school education).

Couple families with dependent children face a different situation and experience substantial churn: the average value of benefits received ($691) is nearly identical to the average value of taxes paid ($689). School education accounts for more than half of the value received in social transfers in kind, and Family Tax Benefits account for more than 60% of the value of cash transfers for these families. Health benefits account for most of the remainder.

All other household types, with the exception of group households, are net beneficiaries of the welfare state, showing relatively high levels of churn. Couple-only families pay around $406 per week in taxes and receive $444 in benefits; 'other one family households' pay $527 per week in taxes and receive $553 in benefits; and lone-person households pay $217 in taxes and receive $319 in benefits. Group households, the only household type that pays more in tax than it receives in benefits, pay $511 in taxes and receive $428 in benefits.

Couple families with dependent children experience substantial churn: the average value of benefits received ($691) is nearly identical to the average value of taxes paid ($689).

Table 3: Government benefits, taxes and household income, household type, average weekly value ($), 2009–10

	One-family households				Non-family households	
	Couple family with dependent children	One-parent family with dependent children	Couple only	Other one-family households	Lone person	Group households
Private income	2,359	705	1,553	2,068	805	1,873
Cash transfers	135	384	170	217	144	138
Education benefits	308	327	10	40	6	115
Health benefits	182	135	216	229	125	140
Social security and welfare benefits	64	94	45	63	34	33
Total income	3,048	1,645	1,994	2,617	1,114	2,299
Income taxes	447	79	227	299	118	282
Production taxes	242	149	180	227	99	230
Total taxes	689	228	407	526	217	512
Final income	2,361	1,437	1,591	2,094	907	1,790
Total benefits allocated	691	961	444	553	319	428
Total taxes allocated	689	229	406	527	217	511
Net benefits allocated	2	732	38	26	101	-83

Source: ABS, *Government Benefits, Taxes, and Household Income, Australia 2009–10*, Cat. No. 6537.

Despite the substantial amount of churn in almost all household types, this feature should not be taken at face value. Parents with dependent children are paying taxes only to receive those taxes right back in the form of family tax benefits, subsidised school education, and health care. However, the situation facing other household groups is much more complicated. For example, 'couple only' households may include households with elderly age pensioners who receive large cash benefits but pay little tax, and young professional couple households (for example, 'double income no kids' households), who receive little or no cash benefits and pay large amounts of tax.

It is reasonable to assume that 'group households' largely comprise younger people (aged 35 or less), but it would be wrong to assume that churn is simultaneous. For example, group households receive around $113 in benefits from tertiary education—more than double any other household group—which means many people living in group households are at university (a claim also supported by the tax this household type pays for alcohol, which is more than any other household group). This suggests relatively low levels of simultaneous tax-welfare churn because these individuals are at university and not necessarily paying large amounts of income tax.

However, this is not consistent with group households paying more in tax than they receive in benefits. Many group households include young professionals who have finished university but are still living in shared accommodation to keep costs low. These individuals will likely be paying higher levels of tax (including higher education loan repayments) while receiving lower levels of benefits through welfare-in-kind.

There is substantial tax-welfare churn throughout most people's working lives.

While it is clear that couple families with children (nuclear families) engage in the most welfare churn, it is worth looking at the ebb and flow of tax-welfare churn through the stages of life. Table 4 provides greater details of when people pay tax and when they receive welfare.

Table 4: Government benefits, taxes and household income, age of reference person, average weekly value ($), 2009–10

	15–24	25–34	35–44	45–54	55–64	65–74	75 and over
Private income	1,373	1,740	1,884	2,142	1,705	838	533
Cash transfers	120	102	151	120	154	328	376
Total education benefits	120	96	242	178	47	11	7
Total health benefits	97	116	146	158	166	246	402
Other	35	42	65	46	57	91	85
Total income	1,745	2,096	2,488	2,644	2,129	1,514	1,403
Income taxes	176	320	359	370	241	58	18
Production taxes	182	180	202	228	190	143	92
Total taxes	358	500	561	598	431	201	110
Final income	1,387	1,595	1,927	2,046	1,698	1,314	1,293
Total benefits allocated	372	355	604	502	423	676	870
Total taxes allocated	358	500	561	598	431	201	110
Net benefits allocated	14	-145	44	-96	-7	475	760

Source: ABS, *Government Benefits, Taxes, and Household Income, Australia 2009–10*, Cat. No. 6537.

There is substantial tax-welfare churn throughout most people's working lives, which starts at a relatively low rate when people are younger; increases as they start a family and send their children to school; but then drops away rapidly as people exit the workforce, move onto the age pension, and consume more health care as they grow older.

This evolution over time makes sense. Households with younger people are generally at university (the $120 average weekly education benefits for this group is mostly accounted for via tertiary education) and may also be receiving income support through Newstart or Youth Allowance.

But after they graduate and move into full-time work, they become net taxpayers. People in the 25–34 age bracket have finished their degrees, so many no longer receive tertiary education benefits; they are also usually fairly healthy and don't require much subsidised health care. Both these factors mean they are net tax payers.

However, as they get older, start a family and have children, these individuals fall back onto the welfare state and become net welfare recipients. People in the 35–44 age bracket receive on average 70% more in total benefits than those aged 25–34. This increase comes from education benefits (their children are going to school) and cash transfers (family tax and child care benefits).

As these households get older they once again become net tax payers—mostly as a result of reduced benefits (mainly education) but also partially through paying more taxes. This can be explained through a number of factors—parents become 'empty-nesters' as their children grow up (join the 15–24 household age bracket) and leave home. Alternatively, their children may drop out of school and enter the workforce, or perhaps parents begin earning enough money to send their child to a private school, reducing the government benefits they receive.

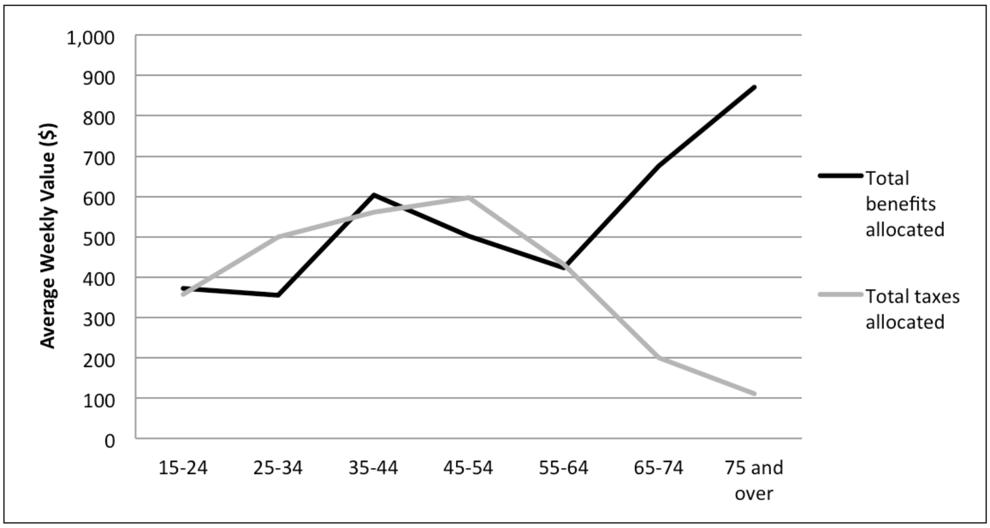
As these households grow older again, and join the 55–64 age bracket, private incomes, taxes and benefits fall—but the nature of those benefits changes markedly. Some people begin their retirement and live off their superannuation, which explains the reduction in private income. Many households are no longer consuming large quantities of publicly funded education, but are instead receiving increasing quantities of publicly funded health care.

This trend accelerates in the 65–74 age bracket as people become eligible for the age pension. Private incomes collapse by more than 50%, from $1,705 per week for the 55–64 age bracket, to $838 per week for the 65–74 age group. This drop is partially offset by a doubling of cash transfer payments—largely because of age pension payments. What is of particular interest is that the 'income' from education benefits falls to nearly zero, while health benefits increase markedly, largely through increased access to hospital services and pharmaceuticals.

For the 75 and older age group, private incomes decrease by a further $300 a week from the 65–74 age group, to $533 per week, but cash transfers and social transfers in kind increase by around $200 a week—mostly through increased health benefits. As a result, over 75s receive a 60% increase, from $475 to $760, in the average weekly value of their net benefits on the 65–74 age group.

Over 75s receive a 60% increase, from $475 to $760, in the average weekly value of their net benefits on the 65–74 age group.

Figure 3: Taxes and benefits, age of reference person, average weekly value ($), 2009–10



Source: ABS, *Government Benefits, Taxes, and Household Income, Australia 2009–10*, Cat. No. 6537.

The tax-welfare churn peaks and troughs as people move through life, but it ends with a 'benefit-tsunami' once people become eligible for the age pension and become more dependent on supports from the aged care and health systems. This illustrates two types of churn—simultaneous churn and lifetime churn. Simultaneous churn occurs when people pay taxes and immediately receive the value of those taxes in the form of cash transfers and benefits. This type of churn is most evident in couple families with dependent children (see Table 3), and policies aimed at reducing family payments and education expenditure would mitigate this kind of churn.

Any effort to reduce lifetime churn must focus on people of working age or older who receive substantial government benefits through income support, health care, and aged care, but are no longer taxpayers. Generally, these people are at the beginning or the end of their working lives. For example, in tertiary education (and the Youth Allowance), supports are given to individuals with the expectation that they will be repaid though general taxation and income contingent loans. Perhaps of greater importance as a means to reduce lifetime churn is the need to tackle the income support system for retirees (age pension and superannuation), aged care services, and health care.

The tax-welfare churn peaks and troughs as people move through life, but it ends with a 'benefit-tsunami' once people become eligible for the age pension and more dependent on supports from the aged care and health systems.

How to reduce churn?

As outlined above, Australia's tough means-testing arrangements for income support payments and highly progressive taxation system have resulted in relatively low levels of churn when compared to other countries. However, there is little or no means testing for many subsidised health and education services, so more means testing in these areas would reduce churn and focus government support on the people who need it most.

However, greater use of means testing comes with its own problems—largely in the form of EMTRs, which reduce incentives to move off government benefits and re-enter the workforce[14]: as they earn more their payments are withdrawn, reducing the financial returns that come from working more. For this reason, CIS Senior Fellow Peter Saunders says policymakers should not aim to restrict welfare but rather 'transcend' it by creating a tax-effective savings vehicle so people could self-fund their own welfare payments.[15]

Saunders suggested creating 'twenty million future funds' or Personal Future Funds (PFFs)—one for every Australian at the time—to allow people to accumulate funds they could draw upon to fund their own unemployment benefits, health care, education or homeownership.[16] The expenditure savings that PFFs create would be returned to families and individuals by increasing the tax-free threshold to the point where people are earning enough to cover their living costs. This would eliminate the need for government aid, simultaneous churn, and welfare dependency.[17]

PFFs would be combined with superannuation reforms aimed at addressing lifetime churn—abolishing taxes on superannuation contributions and requiring retirees to convert some of their superannuation into an annuity when they retire. By reforming superannuation to help ensure retirees live off their own superannuation for longer, retirement savings would be increased and the government's future pension liabilities would be reduced.[18]

Peter Whiteford criticised Saunders' emphasis on returning the savings of reduced churn back to people in the form of income tax cuts.[19] Given that many low income earners, particularly those on welfare payments, do not pay any income tax, Whiteford argues income tax cuts would do little to reduce churn. However, low income households pay relatively more in indirect taxes—for example, in GST and excises on alcohol and tobacco—than they do in income tax. If policymakers want to reduce low income earners' tax liability (and therefore churn), indirect taxes should be reduced instead of income taxes.

Whiteford also raises some practical difficulties occurring in the transition period.

> If a new system were introduced within a short time-frame, those whose children have grown up and recently left home would be significant winners, even though on average they are among the best-off households and have already benefited from substantial transfers. One might envisage a very long phase-in arrangement, where younger households build up private savings accounts while still paying for the pensions and health care costs of the elderly, but most people would experience this as a reduction in disposable income, because they would have the double burden of self-provision while still protecting those who are too old or too poor to make such self-provision. A heavy double burden is unavoidable in any transition to a privatised welfare state, unless current protection for the old and poor is curtailed.[20]

Reforming the welfare state

Whiteford's arguments make any move towards an opt-out system along the lines of Saunders' PFF concept a challenge for politicians and governments. The opportunities for political fear-mongering and muck-raking would likely derail any concerted attempt to reform Australia's tax-transfer system along the lines outlined by Saunders.

A more strategic approach is required to reduce the churn in Australia's tax-welfare system. Rather than a big-bang approach aimed at minimising churn, nuanced and practical policy reforms aimed at key areas of the welfare system should be pursued. These reforms should be aimed at reducing government expenditure and increasing personal responsibility, but with the added benefit of reducing tax-welfare churn. In effect, there is a need to identify reforms in specific sectors that are worthy in their own right, but have the additional benefit of reducing churn as well.

Rather than a big-bang approach aimed at minimising churn, nuanced and practical policy reforms aimed at key areas of the welfare system should be pursued.

The analysis of the current state of tax-welfare churn detailed above highlights the areas of churn that need to be examined, including school and tertiary education; family payments; income supports payments like the age pension, aged care, and health care. A comprehensive case-by-case analysis of each of these areas is beyond the scope of this paper, but the following policy reforms (worthy in their own right) will also help reduce tax-welfare churn.

Box 2: More means testing?

Saunders' PFF proposal aims to 'transcend' the problems inherent with means testing, namely, it creates high EMTRs and reduces the incentive to move off welfare and into work. Given the ambitious nature of introducing a big-bang reform program along these lines, and the low probability that it would be enacted in the short to medium term, there is a need to reconsider tougher and/or broader use of means testing as a tool to reduce government expenditure on welfare services. The savings made through means testing can then be returned to taxpayers via tax cuts. While means testing may not always be the best policy option because of the EMTRs it creates, it remains a realistic option for policymakers interested in reducing government. Current welfare programs not means tested include the Carer Allowance (a fortnightly payment of $115) and the Child Care Rebate (a $7,500 subsidy for out-of-pocket child care expenses).

Social security and welfare

In 2010–11, the Commonwealth spent nearly $117 billion on social security, welfare payments and services. In 2012–13, it expects to spend more than $131 billion; by 2015–16, spending will have increased in real terms by more than $7 billion (from 2012–13 figures) to more than $150 billion a year.[21]

The largest component of this expenditure is for assistance to the aged through the Age Pension and government-provided residential and community aged care. In 2010–11, the Commonwealth spent around $32 billion on income support for seniors; by 2012–13, this increased to nearly $37 billion and is expected to cost the budget nearly $45 billion by 2015–16.[22]

Other significant areas of expenditure include Family Tax Benefits, which cost the budget nearly $18 billion in 2010–11 and increased to nearly $20 billion by 2012–13; and the Disability Support Pension, which cost more than $13 billion in 2010–11 and will reach $15 billion in 2012–13 and $17 billion a year by 2015–16.

In 2012–13, it expects to spend more than $131 billion; by 2015–16, spending will have increased in real terms by more than $7 billion (from 2012–13 figures) to more than $150 billion a year.

Table 5: Commonwealth government expenditure on social security and welfare ($ million)

	2010–11	2012–13 (e)	2015–16 (p)
Assistance to the aged	44,302	51,138	61,344
Assistance to veterans and dependants	6,976	6,898	6,770
Assistance to people with disabilities	20,632	23,978	28,923
Assistance to families with children	30,799	34,152	37,472
Assistance to the unemployed and sick	6,995	8,783	9,727
Other welfare programs	1,843	1,707	1,707
Additional Aboriginal expenditure	1,443	1,200	943
General administration	3,749	3,800	3,468
Total	116,739	131,656	150,354

Source: Budget Paper No. 1, 2011–12 and 2012–13, Table 9. Also note that (e) is for 'estimate' and (p) is for 'projected.'

Note: This includes all Commonwealth expenditure on social security and welfare, not just income support payments. For example, 'Assistance to the aged' includes nearly $10 billion in expenditure on residential and community aged care.

> Currently, more than a quarter of Australian government spending is directed to health, age-related pensions, and aged care. Without action to curtail spending growth, Australian government spending on these functions is projected to increase significantly over the next 40 years, pushing the share of spending to almost half. As a proportion of GDP, spending on health is projected to rise from 4% to 7.1%. Age-related pensions and aged care is projected to rise from 2.7% and 0.8% of GDP to 3.9% and 1.8% respectively in 2049–50.
>
> — The Treasury, *Intergenerational Report 2010*[23]

Age pension

Income support for the elderly via the Age Pension has been a source of continual expenditure growth as the population ages. As of June 2011, there were 2.2 million age pensioners, a marked increase from the 1.8 million in 2001.[24] This rapid rate of growth will continue into the future—Treasury predicts the number of people meeting the pension's age eligibility criteria will increase by around 150% by 2049–50.[25] This expected increase will in turn affect government outlays on income support for the elderly, with government spending expected to increase substantially in real dollars per person from 2009–10 to 2049–50.[26] The age pension is, and will continue to be, a significant source of 'lifetime churn' as people who spent their working lives paying tax receive those taxes back in the form of income support payments later in life. There are a number of areas where the age pension can be reformed to reduce tax welfare churn.

Continuing to increase the age pension eligibility age—which will keep more people in the workforce for longer, increase tax revenue, reduce government expenditure, and allow people to save more for retirement (further reducing pension liabilities)—is one obvious way to reduce lifetime churn. The pension eligibility age for both men and women will increase by six months every two years from 65 years in July 2017 to 67 in July 2023; there have been a number of calls, most notably from the Henry tax review, to continue increasing the pension age beyond 67.[27] The United Kingdom has already taken steps to link increases in life expectancy to the age pension eligibility age. A similar measure should be considered for Australia as well.[28]

However, increases in the pension age are by themselves not enough to reduce lifetime tax-welfare churn; there needs to be further reforms to superannuation to reduce future pension liabilities. A start would be to align the preservation age, the age at which someone can withdraw their superannuation, which is currently 60, with the pension eligibility age, which is currently 65. Because these two ages are not aligned, superannuation does not have the intended effect of reducing pension liabilities. Instead, it becomes a vehicle that helps fund an individual's early retirement, allowing them to reduce their means-tested assets to the point that they become eligible for the pension when they are 65.[29] Aligning the preservation age with the pension age will help ensure people live off their own savings for longer before turning to the welfare state for income support.[30]

This also points to another problem—current arrangements allow people to withdraw their superannuation as a lump sum. This would not be a problem if individuals used this money to purchase annuities or other income-generating assets that would provide them with a regular income, instead of income support. However, the age pension assets test provides incentives to spend retirement savings on anything but self-funded income support. For example, the principal home of an age pensioner is exempt from the assets test.[31] This means retirees can spend their lifetime savings buying a more expensive home, renovating their current home, or going on holidays with the aim of reducing their assets to the point where they are eligible for the pension and its associated perks. Including the principal home as part of the age pension assets test would go some way in reducing government pension liabilities, and therefore, lifetime tax-welfare churn.

The United Kingdom has already taken steps to link increases in life expectancy to the age pension eligibility age. A similar measure should be considered for Australia as well.

Box 3: Pension indexation

Since September 2009, pensions have been indexed to either the Consumer Price Index (CPI) or the Pensioner and Beneficiary Living Cost Index (PBLCI), whichever is higher, and benchmarked to 25% of Male Total Average Weekly Earnings.[32] The PBLCI is weighted according to the basket of goods that pensioners and beneficiaries (largely comprising people on unemployment benefits) purchase. This means heavier weightings for food, pharmaceuticals, utilities and tobacco, and that the PBLCI increases at a rate faster than the CPI.[33] Pensions of three million age and disability pensioners are guaranteed to increase in real terms (at the same rate as CPI) or faster. An obvious (but politically difficult) way of reducing government expenditure on pensions is to cut the rate of pension indexation, perhaps reverting to CPI or a midpoint between CPI and wages, or excluding alcohol and tobacco from pension indexation calculations.[34]

Aged care

Like the age pension, government supported residential and community care are growing sources of government expenditure, with expenditure expected to increase from 0.8% of GDP in 2009–10 to 1.8% of GDP by 2049–50.[35] The 2011 Productivity Commission report *Caring for Older Australians* recommended that government subsidised aged care supports should be provided on a means-tested basis, similar to the age pension but with the additional requirement that the assets test takes into account the value of the principal home.[36]

The Productivity Commission also recommended establishing an 'Australian Age Pensioners Savings Account' scheme that would allow age pensioners to deposit some or all of the proceeds of the sale of their principal home into the account, while maintaining their eligibility for the pension. These funds could then be used to help cover the costs of their care.[37] Both of these measures would entail greater financial contributions from the individuals receiving care and also reduce government spending—reducing lifetime tax-welfare churn relating to residential and community aged care.

Family payments

Family Tax Benefit (FTB) parts A and B are perhaps the classic examples of middle-class welfare and simultaneous churn. FTB Part A is the more tightly means tested of the two benefits; depending on family income, and the number and age of eligible children, a family earning nearly $78,000 a year can receive the full rate of more than $100 a week per child.[38] FTB Part B is a smaller payment—up to $70 a week per child aged under 5 years and around $50 a week for children aged 5 to 18—but the benefit is payable to families where the primary earner is earning less than $150,000 per year and is not linked to workforce participation by, for example, stay-at-home mothers. The government will spend approximately $20 billion in 2012–13 on FTBs. Given the volume of expenditure, FTBs have been rightly targeted as an area for reform. Professor Roger Wilkins of the Melbourne Institute has called for FTB Part B to be abolished, and for FTB Part A to be gradually reduced by 20 cents in the dollar for every dollar earned over $78,000 a year.[39] Reforms along these lines would go a long way to reducing simultaneous tax-welfare churn and middle-class welfare in Australia.[40]

Family Tax Benefit (FTB) parts A and B are perhaps the classic examples of middle-class welfare and simultaneous churn.

While FTBs were designed to provide financial support to families with stay-at-home mothers, there has been much focus recently on expanding the welfare state to help working mothers—prime examples being the introduction of Paid Parental Leave (PPL), the Child Care Benefits, and the Child Care Rebate. Australia's PPL scheme provides the primary carer of a newborn or adopted child with 18 weeks of income support paid at the minimum wage. The primary carer must have met a modest work test to be eligible for the payment.[41] Individuals ineligible for PPL though may be eligible to receive the $5,000 Baby Bonus per eligible child.[42]

Given its focus on working mothers, any PPL scheme essentially provides income support to the middle classes and typically involves some degree of tax-welfare churn.[43] However, the PPL scheme introduced by the Rudd-Gillard Labor government may be replaced with a substantially more generous PPL scheme by a Coalition government if elected at the 2013 election. The Coalition proposes to provide mothers with 26 weeks of leave at full replacement wage levels (up to a maximum of $150,000 per annum) or the Federal Minimum Wage, whichever is greater. The scheme would be funded out of a 1.5% levy on companies with taxable incomes greater than $5 million.[44] Despite the intention to fund the scheme through redistributing wealth from medium to large businesses, the Coalition's $4.3 billion per year PPL scheme will greatly increase middle-class welfare and tax-welfare churn. The Centre for Independent Studies has supported self-funding models as a way to cover the costs of PPL, including using a tax-effective savings vehicle, but failing that, the status quo PPL scheme is preferable to the Coalition's alternative from a financial point of view.[45]

Box 4: The need for wholesale reform of family payments

At the moment, parents can receive a broad gamut of family and child related payments, including FTBs, Baby Bonus, Paid Parental Leave, Schoolkids Bonus, the Child Care Benefit, and the Child Care Rebate, with combined government expenditure to the value of around $34 billion in 2012–13.

The CIS has been a long-time proponent of wholescale reform of Australia's system of family payments. In 2004, the CIS' Peter Saunders and Barry Maley recommended raising the income tax thresholds and introducing a non-means tested Child Tax Credit (worth several thousand dollars per child per year) to replace the existing system of means-tested family payments.[46]

This ambitious reform proposal aimed at making it easier for families to use their own money to raise their children, while at the same time removing some of the perverse incentives that exist for those who want to move into the workforce. Saunders and Maley estimated that their combination of increased tax thresholds and child tax credits, offset by the abolition of means-tested family payments (which when they wrote their report included FTBs parts A and B, the Child Care Benefit, and the Maternity Allowance), would result in a shortfall of approximately $9 billion a year. Saunders and Maley suggested that the difference could be partially made up with reforms in other areas, including Parenting Payment, Newstart Allowance, and the Disability Support Pension.

Generally, the Saunders/Maley recommendations are preferable to the more pragmatic and piecemeal reforms outlined above, like abolishing FTB Part B without a replacement. However, these policy suggestions should not be understood to preclude wholesale reform of the family tax system to improve incentives for people to work and have families. Rather, they should be understood as pragmatic and achievable policy reforms that would reduce tax-welfare churn and government expenditure within the next 10 years.

Unemployment benefits

Given their purpose of providing temporary income support between jobs, unemployment benefits are one obvious area of lifetime churn. Approximately 60% to 70% of Newstart Allowance recipients receive the payment for less than a year before moving back into the workforce.[47] The remainder may remain on the payment for longer, sometimes for many years. As part of his PFF proposal, Saunders proposed scrapping the Newstart and Youth allowances so individuals could fund their own unemployment benefits for up to six months before moving on to Work for the Dole programs until they find employment.[48]

A possible alternative to using PFF-style savings accounts is to enhance existing welfare arrangements for the unemployed and students with income contingent loans. Instead of providing the unemployed with an income support payment, they could be given an income contingent loan, which they will be required to repay once they return to the workforce (along the same lines as HELP repayments). Those individuals who never return to the workforce, or take on low paying jobs, would only repay their debts after they start earning an income above a certain level. Reforms along these lines would entail a greater degree of personal responsibility and may reduce government outlays as the loans are repaid over time.

Instead of providing the unemployed with an income support payment, they could be given an income contingent loan, which they will be required to repay once they return to the workforce (along the same lines as HELP repayments).

Disability Support Pension

The Disability Support Pension (DSP), while comprising a significant part of government expenditure (around $15 billion a year), is not necessarily a strong source of tax-welfare churn because the payment is subject to tight means testing and also because relatively few DSP recipients return to the workforce once they begin receiving the pension.[49] Furthermore, given the strong correlation between poverty and disability, it is possible that many long-term DSP recipients pay little if any income tax over the course of their lives.[50] However, for others who acquire a disability later in life after some time in the workforce, there is a degree of tax-welfare churn because the DSP acts as an early age pension.

Tax-welfare churn relating to the DSP will likely increase because the entire disability sector is on the brink of a massive reform from the National Disability Insurance Scheme (NDIS). The Productivity Commission, as part of its feasibility study into the NDIS, recommended substantial reforms to the DSP to maximise the economic benefits of the NDIS (mostly in increased workforce participation by people with disabilities).[51] The NDIS will provide people with disability the supports they need to enter the workforce. However, the DSP does not have participation requirements, so people with disability may have all the supports they need to enter the workforce, but because they are not required to look for work, they may never make the transition. Reforming the DSP to align it with the objectives of the NDIS may not reduce tax-welfare churn, but it will certainly reduce government expenditure on income support payments.[52]

Immediate reforms to the DSP could include introducing compulsory participation requirements for people with a partial capacity to work.

Immediate reforms to the DSP could include introducing compulsory participation requirements for people with a partial capacity to work. Reassessing the current cohort of more than 800,000 DSP recipients under tougher eligibility criteria introduced in January 2012 would help reduce the number of people on the payment and move more people off welfare and into work. Abolishing the extraordinary and unfair exemption from work, income and assets test for the permanently blind would also reduce the number of people on the DSP.[53]

Education

In 2010–11, Australia's governments spent approximately $76 billion on education. More than $40 billion of this was spent on primary and secondary education, and a further $26 billion was spent on tertiary education (universities and technical education). An additional $9 billion was spent on other areas of education, including preschool and student transportation.[54]

The education expenditure figures include capital expenditures relating to the Rudd government's $16.2 billion economic stimulus package, *Building the Education Revolution* (BER). This spending allowed schools to build new facilities, including libraries and laboratories. At an estimated $9.1 billion, the 2009–10 financial year represented peak spending for the program; a further $5.4 billion was spent in 2010–11.[55]

Table 6: Total government real expenditure on education ($ million) (2010–11 dollars)

	2006–07	2007–08	2008–09	2009–10	2010–11
Primary and secondary education	34,250	34,304	35,445	41,466	40,150
Tertiary education	22,130	23,127	24,650	25,662	26,202
Other education	4,830	5,020	6,680	8,662	9,303
Total	61,210	62,451	66,775	75,789	75,655

Source: Productivity Commission, *Report on Government Services 2013*, Table BA.3.

School education

One way to reduce taxpayer expenditure on school education is by using a refundable tax credit, ideally in the form of a voucher.[56] Instead of paying taxes and receiving a publicly funded school place, parents of school-aged children could spend their own money on providing for their child's education at the school of their choice and then receive a reduced tax bill to the same value in return. Families that do not pay enough tax could receive a top-up cash payment to meet the difference so that all children are still guaranteed a school education. The tax credit could be capped so that families who choose more expensive schooling options would only receive a tax credit to a maximum value—perhaps the value of the cost of attending their closest public school. This funding mechanism would increase efficiencies by creating competition and innovation among all schools, reducing churn, and making schools more accountable and responsive to parents. If we can make current spending more efficient, it would help mitigate future spending growth. Sometimes it is more important to look at how money is being spent rather than how much.[57] In the interim, immediate savings could be found by abolishing large and unnecessary programs with dubious educational benefit, like the school chaplains program and the Schoolkids Bonus, a welfare payment aimed at helping parents cover the up-front costs of sending their child to school.[58]

Tertiary education

While the direct benefits of government subsidised tertiary education accrue to students while they are university or TAFE, the indirect benefits resulting from higher incomes as a result of that education last a lifetime. In *Graduate Winners*, Andrew Norton detailed a series of reforms aimed at reducing tertiary education subsidies for degrees that fail a net public benefit test.[59] For example, someone studying for a degree that would likely result in a higher income, and therefore higher private benefits (for example, law or finance), would receive reduced government subsidies, while those studying in areas with lower incomes but greater public benefits would receive relatively larger subsidies (for example, social work).

Norton estimated the annual savings to government at $3 billion a year. These savings themselves would not be a cut to university funding, as universities would have the freedom to raise student fees to cover their costs. Because the private benefits of studying particular courses are relatively high, higher fees are unlikely to deter students from studying their preferred course, including those from low socio-economic backgrounds. Despite being worthy reforms in their own right, reducing tertiary education subsidies would have the additional benefit of reducing tax-welfare churn.

Despite being worthy reforms in their own right, reducing tertiary education subsidies would have the additional benefit of reducing tax-welfare churn.

Health

The health sector is one area where the broader application of means testing would reduce government expenditure and tax-welfare churn. Medicare is a demand driven entitlement scheme that provides subsidised general practitioner and other primary care services at little or no cost. Because little of the financial cost borne by the health consumers or practitioners, the system encourages overconsumption of primary health care services, and therefore, leads to excessive government expenditure on health.[60] Medicare is not means tested. Wealthy individuals are just as entitled to subsidised primary care services as low income people are. Higher co-payments for wealthy individuals, or means testing of Medicare to the point where high income individuals pay for the entire health care costs are two options that would reduce tax-welfare churn.

Table 7: Government recurrent health expenditure ($ million) (2010–11 dollars)

	2006–07	2007–08	2008–09	2009–10	2010–11
Public hospitals	28,988	30,964	32,382	33,855	35,661
Private hospitals	3,078	3,337	3,421	3,746	3,926
Medical services	13,634	14,780	15,866	16,643	17,600
Dental services	1,128	1,309	1,672	1,913	2,136
Other health practitioners	911	1,149	1,254	1,386	1,439
Medications	6,593	7,161	7,863	8,465	8,721
Other health	13,126	14,615	15,996	16,283	15,818
Total	67,458	73,316	78,454	82,291	85,299

Source: Productivity Commission, *Report on Government Services 2013*, Table EA.2.

Increasing co-payments (for everyone including card holders) and introducing additional means testing for high income people would help reduce government expenditure on subsidised pharmaceuticals and reduce churn.

Similarly, the Pharmaceutical Benefits Scheme provides subsidised drugs and other pharmaceuticals to all Australians. The cost to consumers of these drugs can vary, depending on whether they are eligible for government concession cards (for example, like the Pensioner Concession Card or the Health Care Card).[61] Eligibility for these cards is typically available for those already receiving means-tested income support payments, and the cards themselves provide further subsidies for pharmaceuticals already available in the scheme. Again, increasing co-payments (for everyone including card holders) and introducing additional means testing for high income people would help reduce government expenditure on subsidised pharmaceuticals and reduce churn.[62]

10 tips to TARGET30

So what can policymakers do to reduce tax-welfare churn and get on track to reduce the size of government from 35% of GDP to less than 30% within 10 years? Here are some possible solutions:

1. Reform the age pension and superannuation to ensure more people use more of their own money for their own retirement. A requirement to use superannuation savings to purchase an annuity could ensure that people are living off their own savings rather than the pension.
2. Eligibility for the age pension and the aged care sector should take into the account the value of the family home. People living in million-dollar mansions should not be eligible for income support payments.
3. The age pension and preservation ages should be raised and aligned. Furthermore, they should be increased in line with life expectancy.
4. For an immediate saving of $4.5 billion a year, Family Tax Benefit Part B can be abolished. People earning $150,000 a year are not poor and do not need income support.
5. Greater use of income contingent loan schemes for welfare payments, including unemployment benefits and paid parental leave, should be considered. This will allow more people to be responsible for providing more of their own welfare.
6. The Disability Support Pension can be reformed to realise maximum economic benefits from the NDIS by introducing activity testing and participation requirements for people with a partial capacity to work.
7. The current cohort of DSP recipients should be reassessed under tougher eligibility requirements introduced in January 2012. Furthermore, exemptions from work, income and assets tests for the permanently blind should be scrapped.

8. Means testing can be extended to programs not already means tested, such as the Carer Allowance and the Child Care Rebate.
9. The Schoolkids Bonus could be scrapped for an immediate saving of $1.2 billion a year, and the school chaplains program can also be scrapped. Both are of dubious educational benefit.
10. Medicare and PBS co-payments could be increased and means testing could be introduced.

The way forward

A common theme runs through the attempts to reduce tax-welfare churn and government expenditure. It is widely recognised that more people will have to pay for more of the services and supports they receive from the state, and the common solution is the need for a tax-effective (no tax on contributions or interest earned) savings vehicle that allows people to do just that.

More people will have to pay for more of the services and supports they receive from the state.

Superannuation accounts are perhaps the most widely known and used example of such accounts. Health savings accounts allow people to quarantine savings to use on future health care costs.[63] The Productivity Commission's recommendation of an Australian Age Pensioners Savings Accounts to help people self-fund the costs of their aged care is an example of a tax-effective savings vehicle.[64] Special Disability Trusts perform a similar role in the disability sector.[65] Likewise, First Home Saver Accounts provide tax-free interest earnings to help people purchase their first home.[66] The Personal Future Fund concept brings many of these ideas together into a single coherent package.

But the common problem with all these types of savings accounts is that individuals must have sufficient income to put into these accounts, which they can then draw upon at a later time. If they do not have the savings to cover their necessary expenses, or they have not had enough time to accumulate sufficient assets (for example, the young or migrants), they will likely fall back onto taxpayer-funded services anyway.

While a comprehensive discussion of these issues is beyond the scope of this paper, a possible solution building on existing work on tax-effective savings vehicles is to include in the concept of such savings vehicle income contingent loans for income support payments and other welfare services—in effect, a Personal Savings and Loan Account (PSLA). A PSLA would allow individuals to acquire debts early in their lives (that is, for tertiary education and student income support), which can be paid through income contingent loans paid in addition to the assessed income tax liabilities.

People at the start of their working life are net benefit recipients, and therefore, would draw down on these accounts and accumulate debts via income contingent loans. But as they enter the workforce and become net tax payers, the debts would be paid off and the opportunity to increase savings in these accounts would arise. These savings could then be used to pay for health care, unemployment and retirement benefits, or other welfare state related expenses. The reduction in government expenditure could be returned to eligible individuals in the form of income tax cuts or credits. Tax-effective savings vehicles by themselves do not appear to be a comprehensive answer to reducing the size of the welfare state. A combination of tax-free savings and income contingent loans for income support payments could be the answer.

Conclusion

Given the sheer volume of expenditure associated with the welfare state, the primary role of government (at least during peacetime) is to manage the entitlements and obligations endowed by the welfare state.

Australia's welfare state accounts for a significant majority of government expenditure, and as a result, provides the primary justification for current levels of taxation. Around 50% of welfare state expenditure involves some kind of churn, where the government taxes an individual and then returns those taxes in the form of welfare payments or welfare services.

Given Australia's ageing population and the proliferation of new health, welfare and education programs (Paid Parental Leave, Schoolkids Bonus, the Gonski reforms, and the NDIS), churn is unlikely to go away anytime soon.

Previous attempts to deal with tax-welfare churn may have been overly ambitious. What is needed is a strategic change in how to address churn, and more generally, welfare reform. Rather than a big-bang approach to welfare reform, a more strategic line of attack is needed.

Reform proposals should aim at reducing unnecessary government expenditure in specific areas, with savings returned to taxpayers through reduced taxes.

This report has outlined a number of options for meeting the goal of the TARGET30 campaign. These options may not be an elegant solution to reducing the size of the welfare state but they comprise a solution nonetheless.

Instead of specifically focusing on reducing tax-welfare churn, reform proposals should aim at reducing unnecessary government expenditure in specific areas, with savings returned to taxpayers through reduced taxes. This is a pragmatic and sensible way of achieving a much smaller welfare state than we currently have.

Endnotes

1 Peter Whiteford, 'The Welfare Expenditure Debate: "Economic Myths of the Left and the Right" Revisited' (Sydney: Social Policy Research Centre, University of New South Wales, 2006).

2 For a more detailed discussion of the costs of tax-welfare churn, see John Humphreys, *Ending the Churn: A Tax/Welfare Swap*, Perspectives on Tax Reform (18), Policy Monograph 100 (Sydney: The Centre for Independent Studies, 2009), 2–3.

3 Commonwealth of Australia, *Budget Paper No. 1*, 2012–13 Budget, Table A1.

4 Commonwealth of Australia, *Budget Paper No. 1*, 2012–13 Budget, Tables C5, 6–72 to 6–76.

5 CIS researcher Alex Robson calculated that Australia's 'tax army' was 80,000 strong in 2001–02. This figure includes 25% of all lawyers, 50% of all accountants, and 100% of all ATO tax officers. Note that the 70,000 figure includes all ATO, DHS, FaHCSIA and DEEWR employees, and does not include individuals employed indirectly by the welfare state in the private sector. See Alex Robson, *The Costs of Taxation*, Perspectives on Tax Reform (8), Policy Monograph 68 (Sydney: The Centre for Independent Studies, 2005).

6 John Humphreys, *Ending the Churn: A Tax/Welfare Swap*, as above, 5. Humphreys outlines a scenario where someone could be faced with EMTRs of 85%.

7 Peter Saunders, *The Government Giveth and the Government Taketh Away* (Sydney: The Centre for Independent Studies, 2007).

8 ABS (Australian Bureau of Statistics), *Government Finance Statistics, Australia, 2010–11*, Cat No. 5512.0 (17 April 2012). See Table 939.

9 See ABS, *Taxation Revenue, Australia, 2010-11*, Cat No. 5506.0 (17 April 2012) for taxation statistics, and Simon Cowan, *Target30 – Towards Smaller Government and Future Prosperity* (Sydney: The Centre for Independent Studies, 2013) for expenditure data.

10 As above.

11 Peter Saunders, *The $85 Billion Tax/Welfare Churn*,' Issue Analysis 57 (Sydney: The Centre for Independent Studies, 2005), 12. For a more detailed account on how churn is calculated, see Peter Saunders, *The Government Giveth and the Government Taketh Away*, as above, Chapter 2.

12 John Humphreys, *Ending the Churn: A Tax/Welfare Swap*, as above, 2–3.

13 Technically speaking, the welfare state engages in intergenerational transfers—taxes paid by working adults are transferred as educational benefits to their children, or as health benefits and income support to their parents—transfers between generations at the same point in time. Given that the very young and very old who receive these transfers are not substantial tax payers, Australia has even less churn than this report outlines. This report takes the view that transfers are intragenerational and taxes are paid during working lives and then returned to the same individual during non-working periods. Under this understanding, the government is acting as a 'piggy bank' rather than as 'Robin Hood'. Given the distinction between intergenerational and intragenerational transfers, the importance and magnitude of tax-welfare churn depends on how the transfers are viewed.

14 In comments on a draft version of this report, Peter Saunders noted that EMTRs are one of several problems caused by extra means testing. A strong argument could be made that education is a 'public good' where everyone benefits from a properly educated child. Further means testing also has the potential to penalise children based on their parents' circumstances.

15 Peter Saunders, *Twenty Million Future Funds*, Issue Analysis 66 (Sydney: The Centre for Independent Studies, 2005).

16 The funds themselves would receive initial start-up capital from the proceeds of the sale of Telstra.

17 Peter Saunders, *Twenty Million Future Funds*, as above, 11–12.

18 As above, 11–12.

19 Peter Whiteford, 'The Welfare Expenditure Debate: "Economic Myths of the Left and the Right",' draft paper, 20.

20 As above.

21 Commonwealth of Australia, *2012–13 Budget Paper No. 1*, Box 2, 6–8.

22 As above, Table 9.1.

23 The Treasury, *Australia to 2050: Future Challenges* (January 2010), 47.

24 FaHCSIA (Department of Families, Housing, Community Services and Indigenous Affairs), *Income Support Customers: A Statistical Overview 2011*, Statistical Paper No. 10 (Canberra: FaHCSIA, 2012), Table 1.

25 The Treasury, *Australia to 2050: Future Challenges*, as above, 61.

26 As above, Chart 4.13, 60.

27 John Daley, *Game Changers: Economic Reform Priorities for Australia* (Melbourne: Grattan Institute, 2012); Robert Carling, *Australia's Future Fiscal Shock*, Issue Analysis 134 (Sydney: The Centre for Independent Studies, 2012); *Australia's Future Tax System* (Canberra: Commonwealth of Australia, 2010).

28 Sarah Neville, 'Pension age to be linked to rising life expectancy,' *FT.com* (23 December 2013).

29 Simon Kelly, *Household Savings and Retirement: Where Has All My Super Gone?*, A report on retirement for CPA Australia by KellyResearch (Southbank: CPA Australia, October 2012).

30 These points are outlined in greater detail by Stephen Kirchner, *Compulsory Superannuation at 20: 'Libertarian Paternalism' Without the Libertarianism*, Policy Monograph 132 (Sydney: The Centre for Independent Studies, 2012).

31 DHS (Department of Human Services), *Assets*, website.

32 FaHCSIA (Department of Families, Housing, Community Services and Indigenous Affairs), 'Common provisions affecting indexation of pensions,' *Guide to Social Security Law*, website.

33 The Treasury, 'Weekly Economic Wrap-up,' Treasury Executive Minute, 18 February 2011.

34 See Peter Whiteford's comments, in Peter Martin, 'The middle class has cake, eats it too', *The Sydney Morning Herald,* 14 March 2013.

35 The Treasury, *Australia to 2050: Future Challenges*, as above, 57.

36 Productivity Commission, *Caring for Older Australians*, Report No. 53, Final Inquiry Report (Canberra: 2011).

37 As above, XL.

38 DHS (Department of Human Services), *Family Tax Benefit Part A and Part B*.

39 Patricia Karvelas, 'Foes unite in call for welfare overhaul,' *The Australian* (26 October 2012).

40 One objection to abolishing payments like Family Tax Benefit Part B and other payments to non-poor households is that it could contribute to greater 'horizontal inequity.' The CIS has strongly defended the principle of horizontal equity in the past, largely through the work of Senior Fellow Barry Maley. He has argued that taxes and welfare benefits should take into account how many people in a household have to depend on a given income. While the welfare system often takes into account household incomes through means testing, the tax system does not do this because tax liabilities are calculated on an individual basis rather than a household basis. What this means is that families with two working parents can claim two tax-free thresholds, while families with only one working parent can only claim one tax-free threshold and effectively forfeit the second tax-free threshold because they have chosen to stay at home and look after the children. When compared to two-income families with two tax-free thresholds and no children, the current arrangements can be seen to be unfair to single-income families with a stay-at-home mum or dad because the former get to 'free ride' on the public benefits of having children without contributing to the additional costs incurred in raising them. Transfer payments like FTB Part B aim to ameliorate this unfairness, even for relatively affluent families earning around $150,000 per year. Scrapping FTB Part B, as recommended by this report, will inevitably increase horizontal inequity, but on balance, the CIS believes the priority must be to reduce the overall level of state spending and dependency of government handouts. The long-term solution to horizontal inequity is to reform the tax system to recognise household dependents. Various ways of doing this are explored in Peter Saunders and Barry Maley, *Tax Reform to Make Work Pay*, Perspectives on Tax Reform (3), Policy Monograph 62 (Sydney: The Centre for Independent Studies, 2004).

41 DHS (Department of Human Services), *Parental Leave Pay*.

42 DHS (Department of Human Services), *Baby Bonus*.

43 Jessica Brown, *Million Dollar Babies*, Issue Analysis 102 (Sydney: The Centre for Independent Studies, 2008).

44 Liberal Party of Australia, *The Coalition's Real Action Plan for Paid Parental Leave* (Barton: 2010).

45 Jessica Brown, 'An Alternative Vision of Parental Leave,' *Policy* 24:3 (Spring 2008) (Sydney: The Centre for Independent Studies, 2008), 3–4.

46 Peter Saunders and Barry Maley, *Tax Reform to Make Work Pay*, as above.

47 DEEWR (Department of Education, Employment and Workplace Relations), *2011–12 Annual Report*, 85.

48 Peter Saunders, 'Twenty Million Future Funds,' as above, 9–10. Saunders envisaged that the PFFs would receive a starting amount of $5,000 from the sale of Telstra which could be drawn down over time.

49 Lixin Cai, Hong Ha Vu, and Roger Wilkins, *Understanding the Nature of and Factors Behind Exits from the Disability Support Pension* (Melbourne: Melbourne Institute of Applied Economic and Social Research, 11 August 2005).

50 ABS (Australian Bureau of Statistics), *Disability, Ageing and Carers, Australia: Summary of Findings, 2009*, Cat. No. 4430.0 (ABS: Canberra, 2012).

51 Productivity Commission, *Disability Care and Support,* Report No. 54 (Canberra: 2011), Chapter 6.

52 For a more detailed explication of the arguments for DSP/NDIS reform see, Andrew Baker, 'Disability pension reform key to NDIS success,' *The Australian Financial Review* (20 December 2012).

53 Andrew Baker, 'Ability, not disability, should determine access to support,' *The Canberra Times* (14 July 2012).

54 Productivity Commission, *Report on Government Services 2012*, Table BA.3.

55 Commonwealth of Australia, *2010–11 Budget Paper No. 1*, Table 7, 6–15.

56 Jennifer Buckingham, *Families, Freedom and Education: Why School Choice Makes Sense*, Policy Monograph 52 (Sydney: The Centre for Independent Studies, 2002), 40.

57 A more comprehensive treatment of potential savings in the education sector will be provided under the TARGET30 campaign by CIS Research Fellow Jennifer Buckingham later this year.

58 Tony Abbott, address to the National Press Club (31 January 2013).

59 Andrew Norton, *Graduate Winners: Assessing the Public and Private Benefits of Higher Education* (Melbourne: Grattan Institute, 2012).

60 Jeremy Sammut, *How! Not How Much: Medicare Spending and Health Resource Allocation in Australia*, Papers in Health and Ageing (11), Policy Monograph 114 (Sydney: The Centre for Independent Studies, 2011).

61 DHS (Department of Human Services), *Health Care Card*, website.

62 As part of the TARGET30 campaign, CIS Research Fellow Jeremy Sammut will provide a more comprehensive overview of policy measures aimed at reducing government expenditure in the health sector later this year.

63 Jeremy Sammut, *How! Not How Much*, as above.

64 Productivity Commission, *Caring for Older Australians*, Report No. 53, Final Inquiry Report (Canberra: 2011), LXIV.

65 DHS (Department of Human Services), *Special Disability Trusts*, website.

66 ATO (Australian Taxation Office), *First Home Savers Accounts—Home*, website.

TARGET30

REDUCING THE BURDEN FOR FUTURE GENERATIONS

Author

Andrew Baker is a Policy Analyst at The Centre for Independent Studies. Before joining the CIS, Andrew worked in a policy research and advisory capacity for several members of the Australian Senate. He has a master's degree in Public Policy and Management from the University of Melbourne and a BA (Hons) in Philosophy from Monash University.

THE CENTRE FOR INDEPENDENT STUDIES

CIS TARGET30 • T30.02 • ISSN: 2201-7615 • ISBN: 978 1 922184 13 9 • AU$9.95
Published March 2013 by The Centre for Independent Studies Limited. Views expressed are those of the authors and do not necessarily reflect the views of the Centre's staff, advisors, directors or officers.

This publication is available from the Centre for Independent Studies.
PO Box 92, St Leonards, NSW 1590 Australia • **p:** +61 2 9438 4377 **f:** +61 2 9439 7310 **e:** cis@cis.org.au