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REDUCING THE BURDEN FOR FUTURE GENERATIONS

THE CENTRE FOR INDEPENDENT STUDIES

Welfare reform: Beyond decades of dependence, 'dole bludgers' and 'double dipping'

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Introduction

Dr Jeremy Sammut

The two essays in this Occasional Paper take divergent approaches to the reform of the welfare state, while both focusing on the perennial hot button issue of so-called 'middle class welfare'.

Simon Cowan argues that given the size of federal government payments to Australian families, the only way to shrink the size of government is to restore the role of welfare – transfer payments – to its original purpose of alleviating the poverty of those unfortunates most in need of government assistance.

Barry Maley argues that family payments are a legitimate and socially important form of entitlement based on pure mathematics, if for no other reasons. Families raising children have more mouths to feed and deserve to have their incomes treated differently – more generously – than those who are not responsible for raising children.

Both essays thus address the perennial debate about 'vertical' and 'horizontal' equity. Cowan thinks that only by focusing on vertical equity – redistribution of income to the poorest groups – will we be able to cut tax and cut the size of government. Maley thinks that horizontal equity (and inequality) is as real as vertical, on top of which are the social arguments for financially supporting the families with children.

The politics of welfare reform are difficult: most people are willing to support those who need help through no fault of their own; but they also resent loafers who bludge and rort the system.

Targeting assistance to those in genuine need would be welcomed by hard-working taxpayers – if only the long history of the welfare state did not reveal that it creates perverse incentives and leads people to seek the maximum income for the least effort.

Working families might therefore look twice at the idea that they should not get their taxes back to help support their own children, in order to plough even more money into welfare payments for the unemployed, disabled, and carers that are vulnerable to 'gaming' by recipients.

By setting out both sides of the debate about welfare reform, this Occasional Paper will help policy makers and pundits think more clearly about the true purpose of welfare.

Dr Jeremy Sammut.
Senior Research Fellow.
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Perspective: Child support in the welfare and tax systems

Barry Maley

Allowances from the federal budget for the support and care of children currently total $27.5 billion. There are suggestions (p.X) that government support through payments or tax concessions should pass a 'public good' test, where public good is defined as a public service that is not excludable, that an individual may be free to access it, and that access by some does not exclude its use by others. And, moreover, that the benefits accrue to everyone generally, not to one person in particular.

Additionally, public 'positive externalities' or 'benefits' require that they would not be consummated without government funding, and that the cost of funding does not exceed the benefit received. These are rigorous but rational requirements in calculating public expenditure, even though there may be problems in assessing 'benefits' and their magnitude.

We will shortly return to these issues, but it is useful to quote an example of the kind of argument for public support for families with dependent children, that assumes — without argument — the achievement of public benefit and a just case for taxation concessions.

In an article in the *The Australian*, May 27, 2013, well-known economist Henry Erga, said in discussing the case for child support through the tax system:

"Judged in terms of capacity to pay, a family with two children and an income of $80,000 is obviously different from a couple with the same income and no children; the first has an income per person half that of the second. Ignoring, for the moment cost differences between children and adults, the first should therefore pay no more tax, in net terms, than would four people with an income of $20,000, while the second should pay the amount that would be paid by two unrelated people earning $40,000." And, further on "...other countries, including Australia take little account of family size in the income tax structure but make compensatory payments through the welfare system. However, precisely because our system stringently means tests those payments, they do little to ensure horizontal equity at middle income levels. Middle income families with children therefore face far higher tax rates on per capita income than do families without". He concludes: "There is consequently an argument that we make too little, rather than too much, provision for the difference in capacity to pay between families with children and those without."

Such a view of entitlement for families with children was opposed as unjustifiable by the distinguished American economist, Herbert Simon, who argued that having children is a free, voluntary choice — especially in conditions of reliable and cheap contraception — with foreseeable consequences, and that having a child therefore constitutes a private benefit or 'consumer good'. Implicitly, Simon therefore believed that having a child was neither a 'public good' as defined above, nor a 'positive externality' and, accordingly, that the parents should be wholly responsible for its care if they had the capacity to do so and had no legitimate claim on government support or tax recognition.

This is a straightforward and plausible view. It is notably 'individualist' and robust in dismissing the kind of argument expressed by Henry Ergas. But does it take full account of considerations that might be relevant?

The institutional character and functions of marriage and family

The first duties of government are the defence and preservation of the nation and care for the institutions which advance and strengthen it. Prominent in achieving those ends is the institution of marriage and family. Marriage is not a 'right' but rather a conditional status available for all men and women who meet those conditions as spelt out in family law and legislation. Their objective is to foster justice, stability and cooperation within the marriage and to protect appropriate care for dependent children. We might conjecture that there is a broader civil purpose implicitly in mind here to maximise the potential of the marriage relationship to achieve certain disciplines, to promote division of labour, cooperation, various forms of production and wealth-creation and, above all perhaps, to have the children who will contribute to the defence, preservation and continuity of the nation.

The crucial question is whether the public interests mentioned above would be as well achieved in the *absence* of the institution of marriage-and-family and the environment it creates for various forms of productivity and wealth-creation. We have a body of social science evidence that indicates that it would not. The substantial achievement of these ends through marriage-and-family (granting a quantum of failures) would constitute the 'public good', 'positive externality' and 'benefit' required to justify specific governmental support.

From this institutional perspective, rather than the 'individualist' approach of Herbert Simon, the family is a wealth contributor in securing, at considerable cost, the development of its children to become producers-at-large. This function (and legal duty) requires recognition by the welfare and taxation systems and to be treated accordingly. The family as a productive, civilising 'farm' is not a ridiculous image. Let us look at a less-than-perfect analogy, but a useful one.

When a farmer's cow gives birth to a calf, and the calf is raised to adulthood and sold, the farmer makes a gross profit. He has made a contribution to national wealth and his profit is then taxed. But the tax is calculated after the farmer has been allowed by the state to deduct the legitimate costs involved in raising the calf against the sale price. This particular farmer may be ten times richer than his calf-raising-and-selling neighbour, but both are allowed to subtract the costs of raising and selling their stock in exactly the same way. The financial situation of the two producers may be unequal but both have been treated equally and fairly by the taxation system (with the very wealthy farmer paying more income tax) and the society concerned is better off. A 'positive externality' has been achieved.

Is a human child less valuable, and an economic nonentity, in comparison with a calf?

Barry Maley.
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Welfare reform beyond decades of dependence, 'dole bludgers' and 'double dipping'

Simon Cowan

Where we are, and how we got here
The Commonwealth government spends almost $160 billion a year under the heading of social security and welfare. This includes a number of different welfare payments, most notably unemployment benefits, the disability and age pensions and family payments. Many billions more are spent on providing what might be thought of as essentially welfare in kind in education and health, but these are not the subject of this essay.

Seven of the top 20 programs by expenses in the 2016-17 budget are in the social security and welfare space, with this certain to rise to eight when the National Disability Insurance Scheme is fully operational in two years' time.[1]

Program	Cost
Income support for seniors	$45.4 billion
Family tax benefit	$19.3 billion
Income support for the disabled	$17.1 billion
Residential and flexible care	$11.3 billion
Job seeker income support	$10.5 billion
Income support for carers	$8.4 billion
Child care fee assistance	$8.2 billion

A number of contrasting philosophical approaches to welfare have caused the system to look the way it does today. The current approach of those seeking to limit the scope of the welfare state is to focus primarily on those seen as emblematic of passive welfare receipt, people of working age receiving benefits and not in work. While this approach has some justification in morality and fairness, and has kept unemployment benefits 'lean and mean', it has certainly not slowed down the advance of the welfare state as a whole in western countries.

This essay investigates whether a more hardline small government approach, one with a different focus, might actually be more successful in reversing the trend of 'welfarism'. Counterintuitively, it may be that the only way to shrink the welfare state is to embrace a generous safety net, and indeed refocus the welfare system entirely around alleviating poverty and need.

Welfare with a purpose

While the specifics of the various payments are often debated, and the overall cost is noted (often with concern), rarely are the bigger picture issues around welfare discussed. The first and most obvious question is what is the purpose of welfare? Though it may seem simplistic, it is not a trivial question: without a clear sense of the reasons for providing assistance in the form of welfare it is impossible to judge whether it is a success or not.

The absence of an understanding of the reasons for welfare may be a reason why analysis of the welfare system defaults to a binary assessment of who wins and who loses out of proposed changes, with a particular focus on those who lose out. This in turn makes the system very hard to change without increasing the overall size, as recent attempts to remove compensation for a repealed carbon tax have shown.

Welfare is different to the provision of public goods (such as roads) or universal government services (such as health or education) for the very reason that each payment is directed at a discrete cohort of people for a specific reason, typically with conditions attached. While individual payments may deal with different circumstances, in order for the system to function coherently there must be a harmony to the purpose behind all payments. If payments work at cross purposes, inconsistencies in the system will create perverse incentives, public trust in the system will fall, complexity will increase and costs will blow out.

So what is the purpose of welfare? While one obviously important perspective is that of welfare recipients themselves — after all welfare is how they survive and support their family — this is not a particularly helpful starting point for a system wide review. After all the welfare system is primarily an instrument of public policy and as such, like all public policy, it is necessary to examine the benefits and the cost.

A report by the Reference Group of Welfare Reform chaired by Patrick McClure identified five core values of the welfare system that might give some guidance as to the purpose of the system:

- supporting people to participate both economically and socially;
- building capability through skills and training;
- treating all Australians with respect and dignity;
- providing equity across the welfare system; and
- ensuring a basic standard of living for income support recipients.[2]

However several of these core values are in fact a means to an end. For example, the government doesn't want people to have a job for the sake of having a job, but for the economic and social benefits it provides. Nor are all of these core values specific to the welfare system: building capability through skills and training is the core purpose of the education sector, while treating Australians with respect and dignity could arguably be a component of any government services.

Also notable from this list are some absences, especially promoting gender and racial equality — though both arguably fall under a bigger heading which is also missing: remedying inequality.

Ultimately, welfare is a catch-all name for redistribution of income from taxpayers to recipients (two groups that overlap and are far from homogenous) that is not payment for services provided or satisfaction of a debt or existing claim on government. As such the purpose of that redistribution can really only be either to alleviate poverty (need) or to remedy inequality (fairness). Australia does not have a system of social insurance and therefore the argument of payments based on entitlement from prior contribution is flawed.

The Henry Tax Review agrees noting "the primary purpose of government assistance payments is to ensure a minimum adequate standard of living, taking into account individual circumstances and prevailing community standards."[3]

A note on positive externalities

Universal or quasi-universal payments such as parental leave and childcare rebates could potentially be justified on the basis they generate a benefit for the public. At times this argument is used interchangeably but incorrectly with the characterization of these payments as 'public goods'. This misnomer is perhaps not an accidental one. A public good is a product or service that is non-excludable (an individual cannot easily be prevented from accessing it) and non-rivalrous (use by one person doesn't limit the use by others).[4] The benefits accrue to everyone generally, not one person in particular. The most obvious example is national defence. These characteristics lend themselves to public provision of those goods, paid for through taxation, rather than private provision paid for by fees for use or access.

Childcare, paid parental leave and other welfare payments do not have the characteristics of public goods. They are money or services provided directly to individuals who qualify, and as such are obviously excludable and rivalrous (no other person can have the money provided to the recipient). Their benefit flows directly to the person who receives the payment or service.

What these payments and services (arguably) generate are positive public benefits in addition to that private benefit. That benefit is called a positive externality and is secondary to the primary benefit, which accrues to the person receiving the payment or service. Education is an example of a positive externality: the main beneficiary of a child receiving an education is the child himself, but there are additional 'spill-over' benefits to society that come from its citizens being educated (eg higher expected lifetime tax receipts).

The distinction between public goods and positive externalities is important. Government is reasonably expected to fund and provide public goods, however government should only fund positive externalities if two criteria are met:

1. the benefit of the positive externality would not be received without government funding; and
2. the cost of government funding does not exceed the benefit received.

In short, government intervention should occur only to maximize the benefit from the externality. Incentive payments should be targeted to minimize the payments made to those who would undertake the activity anyway. There is no general cause for taxpayers to compensate people for the generation of positive externalities, even if that person incurs a financial cost to do so.

In practical terms the difference in cost may be substantial: for example if paid parental leave were a public good, government would be expected to provide it for all citizens. As a positive externality, the government would fund parental leave only for those who couldn't fund such leave themselves, in the absence of intervention — and only then if the benefit exceeded the cost of doing so.

Given this substantial difference in funding obligations, it would be surprising if the misuse of the term 'public good' by those who want increased government funding was an accident.

More importantly, in the welfare space, being unable to meet the cost is far and away the most likely reason someone who would otherwise generate a positive externality, through childcare or paid parental leave, would not be able to do so. This makes 'need' quite a good proxy to test when looking at subsidies for positive externalities; suggesting that paid parental leave and childcare should fit into the welfare model above.

Fairness, need and equality

While the objectives of need and fairness obviously overlap in a number of ways, fairness is a much grander and more complicated goal. Payments such as paid parental leave, family benefits, childcare rebates and the age pension (among others) all go well beyond the purpose of alleviating poverty, each incorporating elements of fairness, typically the idea of remedying inequality.

Inequality in this context is not limited to the commonly understood meaning of the difference between the rich and the poor. In the case of family payments for example, the supposed inequality to be remedied is the difference in costs faced by people with kids and those without. In the case of paid parental leave, it is inequality between men and women (though this is obviously not the only motivation for paid parental leave, as discussed below).

The problem with fairness as a basis for the welfare system is that it is subjective, while poverty is objective. There may be some debate over the necessary minimum standard to say that someone is or is not in 'poverty' but whether someone meets that standard, and therefore does or does not 'need' government support, is clear. In addition, the success or failure of that policy is quantifiable: the policy either brings the person out of poverty, or not. Fairness on the other hand is much harder to define, achieve and measure. Nor should it be taken for granted that government intervention to ensure equality of outcomes is, by definition, fair.

For example, is it necessarily unfair for women to trade off a higher salary for paid parental leave, provided the choice is freely made and up to the individual? What if there was no wage penalty associated with provisions for paid parental leave but the burden of compulsory leave on business meant that fewer women were employed overall: does that achieve fairness? Is it fair to impose additional taxes on those who don't (or can't) have kids to pay for the choices of those who do? If Australia instead imposes higher taxes on corporations to fund childcare, and this causes businesses to relocate offshore and people to lose their jobs, is that fair? From whose perspective do you measure fairness?

These questions are even more important when considering demographics and the incentive to vote for benefits for your age and social group. We are much more likely to think benefits that flow to ourselves are only fair but those that flow primarily to others are not. For example when the baby boomers were in their twenties and thirties, unemployment benefits were comparable to the generosity of the age pension. Now the boomers are approaching retirement, the difference between these payments is thousands of dollars a year — despite today's retirees being more affluent than ever before. There may be policy reasons for such a divergence, but there are also political ones.

Intergenerational fairness and the age pension

Since its introduction in 1908, the cost and reach of the pension system has steadily expanded. The percentage of the population in the retirement age band has risen from less than 2% in 1911 to almost 11% in 2011, while the percentage of people in that band receiving the pension has increased from around 30% in 1911 to 75% in 2011.

The full rate of the pension has grown significantly in real terms over the years; from $3,000 a year in 1911 to more than $20,000 (in 2012 dollars).

The means test has become much more generous: the upper limit of assets was just under 12 times the full rate of the pension in 1911, whereas today the ratio between the single homeowner assets test cut-off is nearly 35 times the full rate (despite the massive increase in the full rate of the pension over that time).

Pension costs as a percentage of wages are at the highest level they have ever been, having doubled over the past 45 years. Pension costs are projected to increase another 50% against wages by 2055.

Increasing life expectancy has also impacted on costs. Prior to the 1970s, the primary change was rising life expectancy at birth increasing the number of people who reached retirement age, with an increase in life expectancy of 1 year for every 4 years between 1880 and 1970

Since then, there has been marked growth in life expectancy at 65, increasing the average time spent in retirement by more than 6 years for women and nearly 7 years for men

Regardless of the causes, the effect of this growth in income transferred from those of working age to retirees has made the bargain between the generations unbalanced. Each successive generation is asking more of the next generation than they were willing to contribute to past generations. The average worker is now expected to contribute $3,500 a year to everyone else's retirement, but only $6,270 to their own.

Moreover, at times different versions of fairness are in conflict. For example, paid parental leave and childcare are both justified as remedying inequality between men and women, yet paid parental leave for high income women or childcare payments to millionaire families are both opposed on different fairness grounds.

For many years, The Centre for Independent Studies has supported certain welfare benefits, especially benefits for families, on the basis of an idea of fairness called horizontal equity.[5] Horizontal equity is variously described as 'equal treatment of equals', equity between families with children and those without, or more specifically that people on similar earnings should end up with similar disposable income.[6]

The benefits that have been advocated take several forms but include a universal child benefit, and / or additional tax relief or payments for single income families.[7] These payments have been justified by a number of people on several different bases: the cost of raising children is substantial; society compels parents to incur the cost of raising children; taxation should be based on the number of people dependent on a particular income; the disposable income of parents and non-parents should be the same for any given level of income; children become taxpayers and therefore benefit society; children who benefit from payments will eventually pay for others benefits and so no-one would miss out, and others.

From time to time these arguments have found favour with government: Australia had a universal child benefit for a number of years, while in more recent times former Prime Minister Howard championed family tax benefits for sole income families as a way of introducing de facto income splitting; addressing the perceived unfairness of one income families having the benefit of one tax free threshold while two income had access to two.

Some of these arguments can be disposed of fairly quickly — as noted above there is no general case to compensate someone for generating a positive externality (creating new taxpayers) — while others ignore significant drawbacks that would not be overlooked in any other area of welfare. Making the family the primary unit for taxation purposes, as opposed to the individual, adds a major degree of complexity to the tax system. While no-one may miss out from a universal child benefit, that does not mean there are no costs from this lifetime welfare churn — or that families do not have other options to manage lifetime consumption choices that make government intervention unnecessary.

However the bulk of the arguments for these benefits simply reflect a particular set of values, ones that are strongly held but not universal. The more specific the definition of horizontal equity above, the more controversial it is. Very few people would disagree with the fundamental idea of treating equals the same. It is much less widely accepted that the fact that children cause you to face greater costs should trigger an entitlement to government intervention, either through specific tax relief or through welfare payments, when so many other factors impacting disposable income (eg differentials in housing costs) do not.

Having a child may be the most important choice you can make, but it remains a choice; one not open to everyone and one that should not be entered into on the basis that government will pick up the tab for additional costs.

Indeed, choosing between need and fairness is as much about competing visions of the purpose and role of government as it is about different versions of fairness and equity. Guaranteeing that the basic needs of everyone in society will be met is a minimalist form of equality of opportunity. However, disposable income is a measurement of an outcome. Therefore, using horizontal equity as a basis for universal or near universal family benefits implicitly concedes that the government should intervene, not only to ensure equality of opportunity but also to ensure certain types of equality of outcome.

Which means, in effect, some advocates on the left and the right agree it is fair to use the power of government (especially taxation powers) to effect a particular desired outcome. There is disagreement only on who is deserving of intervention. For example, those who advocate in favour of women's rights often have difficulty supporting family benefits for stay-at-home mothers, while some advocates for Family Tax Benefit part B (such as the National Party) generally oppose quotas to remedy gender inequality[8].

Invariably, and perhaps inevitably given that the issue is cash transfers, the focus is on government ensuring certain groups meet a particular living standard — not an agreed minimum standard but a level above this. For those in favour of intervention to support women and minority groups, this standard is typically set by reference to the average incomes of white men. For those advocating payments to families and retirees, the reference point is to income prior to children or retirement.

There are very good reasons why small government advocates oppose government intervention to equalise outcomes, including the inefficiency inherent in government intervention, its track record of failure to achieve its goals, and the simple fact that it is impossible for an intervention to be 'fair' to everyone. Beyond this, there is a substantial cost to a horizontally equal family benefits system that would not apply to one based more on need: two of the top 20 most expensive government programs are family benefits and childcare assistance — and the latter is growing much more rapidly than programs with stricter means testing.

It seems to make more sense, and to be more ideologically consistent, for those who advocate small government to oppose universal family benefits, rather than to make them an exception to this general rule of opposing government intervention to equalise outcomes.

There is a further question for those who seek to use welfare payments as a means of 'valuing' certain contributions (eg paid parental leave or stay-at-home mothers) and change attitudes that drive unequal treatment. There is some evidence from the US that historically negative attitudes towards welfare are correlated with negative attitudes towards minorities — suggesting that, far from welfare making people less likely to have discriminatory attitudes, for some it's the opposite.[9] Moreover, if the purpose of some welfare payments is to make society value non-economic contributions more, it is worth asking whether a meagre, subsistence level payment conveys any real sense of value.

Yet the trend has been away from these larger, universal payments and towards leaner, means-tested ones — historically family related payments, such as maternity allowance paid to mothers on the birth of a child and the child endowment, were universal — while calls for substantially increased paid parental leave payments, or universal childcare, have not been heeded.

In addition, it could be argued that a system based on need is the fairest system as it is does not discriminate between individuals. Certainly a system based on need is a simpler one, with straightforward means testing that can be applied across a number of payments.

For those reasons and others, it is preferable for the primary purpose of the welfare system to be alleviating poverty. To the extent that transfer payments are made to those not in poverty, it should only be on the basis they generate a positive externality, and the conditions in the box above regarding the case for government intervention should be strictly adhered to.

The difficult concept of poverty

The relative simplicity of a needs based welfare system does not mean there are no complications with such a system. The definition of 'poverty' is tricky. Indeed, if you accept one conventional definition of poverty as being below a percentage of median income, there may be no functional difference between a welfare system focused on reducing income inequality and one focused on need.

In addition, standards need to reflect that each payment serves a different cohort, facing different circumstances, and the needs of each cohort may be different. For those on payments designed to persist over time, the cost of large one-off or annual expenditures (like replacing whitegoods or renewing car registration) must be included. For those receiving a payment like Newstart that is arguably designed as a transition payment between jobs, these costs should be discounted. In fact one of the problems with the adequacy of Newstart stems from the fact that one payment is attempting to achieve two very different purposes: Newstart functions both as a transition payment for those between jobs (the majority of recipients) but also a catch-all payment for the long term unemployed.

Having identified the overall purpose of the welfare system, it is then necessary to specify the purpose of each welfare payment and the measurable objectives that would indicate the payment is a success. Payments that overlap should be consolidated. It is unnecessary to have a number of different payments aimed at assisting families — eg family tax benefits and single parenting payments — if all the payments have the same purpose of reducing poverty in families.

As there is no reliable, regularly updated, measure of minimum living standards that takes into account all these factors, a necessary step in reassessing welfare is the creation of such standards.

Effective marginal tax rates and poverty traps

Marginal tax rates are the percentage of each additional dollar earned that is paid in tax. They reflect the incentive for additional labour or investment. However, for those receiving welfare there is another hurdle: as they earn additional income, their welfare payments are reduced and (at maximum levels) withdrawn. The combined impact of the loss of income through tax and welfare withdrawal is known as the effective marginal tax rate or EMTR. An EMTR of 100% or greater means that additional work will provide no benefit in terms of additional income.

High EMTRs are a byproduct of means testing, especially in circumstances where recipients are getting multiple welfare payments with different taper rates. In effect there is a simple trade-off: the tighter the means testing, the cheaper the cost of the benefit to taxpayers — but the higher the effective marginal tax rate for those seeking to move off a payment.

At high levels, EMTRs may provide a significant disincentive to move off welfare and into work. For example, someone moving off Newstart may face a marginal tax rate of $0.19 cents in the dollar, the imposition of the Medicare levy, as well as a taper rate on Newstart payments of $0.60 in the dollar. It should also be noted that a properly targeted means test would taper payments at income levels where support is needed less, meaning that the primary concern should not be whether high EMTRs are unfair but how big the disincentive effect is.

A 2006 study found that the equivalised disposable family income deciles with the highest percentage of working age Australians facing EMTRs above 50% were the 4th, 5th and 6th deciles.[10] The next highest was the 8th decile.[11] The prevalence of high EMTRs among those in the bottom two deciles was quite low, and it is hard to imagine these circumstances have become worse for them since then given the massive increase in the tax-free threshold in 2012. The majority of Australians facing high EMTRs were couples with children, though sole parents with children were the most likely to face high EMTRs.[12] Evidence from 2002 also suggests that the presence of children is one of the main causes of high EMTRs, especially the taper on family tax benefit part A.[13]

However the important point is not whether EMTRs are high; it is the extent to which they actually discourage participation. Although it may seem counterintuitive, in a system with modest benefit payments, high EMTRs should be less likely to be an issue for those on lower levels of income. First, the marginal rate of tax paid at low levels of income is relatively small — those earning $37,000 or less are paying less than $0.20 in the dollar in tax, while those earning less than $18,200 pay no tax — so EMTRs approaching 100% are highly unlikely for those on very low incomes. Second, unless they are receiving substantial benefit payments or are supported by someone else, those on very low incomes cannot afford to decline additional income, even if the benefit from each additional dollar earned is relatively low. In other words, if you really need the money, you'll work more even if the reward is relatively small.

The empirical evidence on the extent that high EMTRs discourage participation isn't clear. There is anecdotal evidence on particular groups — e.g. families receiving childcare, especially those with a second income earner also receiving income support — and estimates of elasticity of labour supply. These estimates tend to suggest that married women are probably more sensitive to EMTRs than married men, and that single parents are responsive too[14].

It makes sense that primary care givers and second income earners, as married women are more likely to be, would be sensitive to EMTRs. Single parents too, as recipients of the largest welfare transfers among working age Australians, would likely to be sensitive to changes. However, categories such as single parents and married women include enormous diversity in income and circumstances.

It is significant that family tax benefits are one of the big drivers of high EMTRs and also affect the group whose participation is most likely to be impacted by high EMTRs. As noted above, the purpose of family tax benefits extends beyond alleviating poverty (need), though that doesn't mean a redesign of family tax benefits will solve the problem of EMTRs. Given the income tax system focuses on single income earners, while family benefits are about family income, there will always be some mismatch.

However it is possible to imagine a welfare system where, even if EMTRs were high, those EMTRs may have little effect on participation. Such a system would have benefits tightly focused on the very poor and the payments would only just be enough to subsist on — set at, or near, poverty levels. It is only as payment levels rose that EMTRs would become a greater discouragement to earning income.

Rethinking an old approach

Functionally, need is represented by the concept of means testing. Means testing should be based on a simple principle: those with the ability to support themselves should be expected to do so. The often unspoken corollary of this is that people who have the ability to put themselves in a position to support themselves are expected to do so.

The sentiment that our welfare system should not support those who don't try to find work is quite prominent, which leads to articles on the prevalence of 'dole bludgers'.[15] Bob Hawke's 'surf team' may have been a real phenomenon, but its 'members' are unlikely to represent a significant proportion of the unemployed.[16]

Unemployment benefits have a relatively minor cost compared with the overall welfare system (less than 10% of the welfare budget).[17] Too much focus and energy has been expended by those supposedly concerned about the cost of the welfare system worrying about the 'unfairness' of dubious recipients of unemployment benefits, which has allowed the rest of the system to grow unchecked.

We must reject the notion that someone is entitled to a benefit not because of need but because of their status, be it race or gender.

This rationale must equally apply to the idea that someone has earned a welfare payment by virtue of their status as former taxpayers or that they are supporting a family.

In fact, the only way to substantially shrink the welfare budget is to reject altogether the idea that transfers of income can be justified on fairness grounds other than need. Welfare should be solely focused on properly assisting those who cannot afford to look after themselves. By that measure, restructuring unemployment benefits, though far from perfect, would not be the first priority.

It is the payments that are made outside the structure of alleviating poverty that are problematic. If they are reevaluated on the basis that they generate a measurable benefit for society that exceeds their cost, payments such as PPL, family benefits or even HECS (though not a welfare payment) may look substantially different.

One such benefit is a reduction in future welfare costs, which is behind the New Zealand 'investment approach' to welfare.[18] This could also support superannuation tax concessions, though there is a real question whether the cost of these concessions delivers any real benefits in terms of future pension savings.[19]

Evaluation of Paid Parental Leave

In November 2014 the Institute for Social Science Research submitted the 4th and final report evaluating Paid Parental Leave. Unlike many welfare programs which go largely unevaluated, this allows us to assess not only whether Paid Parental Leave achieved the goals it set out to achieve, but how efficient it was in meeting those goals.

The Paid Parental Leave act set out the objectives of the Paid Parental Leave scheme. The scheme consists of two payments (parental leave pay, and dad and partner pay), that are intended to:

1. Signal that taking time out of the paid workforce to care for a child is part of the usual course of life and work for both parents; and
2. Promote equality between men and women and balance between work and family life.[20]

It also addresses the purpose of individual payments. Parental Leave Pay, the main payment for carers of newborns and adoptees, is paid at the minimum wage for a maximum of 18 weeks. Relevantly, the purpose of Parental Leave Pay is to:

1. Allow carers to take time off work to care for the child after the child's birth or adoption;
2. Enhance the health and development of birth mothers and children;
3. Encourage women to continue to participate in the workforce; and
4. Promote equality between men and women, and the balance between work and family life.[21]

The evaluation notes the Paid Parental Leave scheme seeks to achieve its main policy goals largely by removing or reducing financial barriers to parents spending more time away from work with their newborns or newly adopted children.[22] This is key particularly to the first two objectives, as it is hard to see how a cash payment would change the behaviour of those who do not face financial barriers to taking time off after birth.

As the evaluation notes, this means the assessable metrics of Parental Leave Pay are the number of eligible women who stay home after the arrival of the baby, and for how long. The evaluation looks at two time periods (18 weeks and 26 weeks), finding that at the 18-week mark just over 85% of mothers post-Parental Leave Pay had not returned to work (compared with nearly 78% pre-Parental Leave Pay) and that there was no change at the 26-week level. This suggests that for the time Parental Leave Pay is paid, it is effective at increasing the number of women who take some additional time off after birth but not effective at increasing the number of women who take 6 months off.

However, in light of the framework above, if paid parental leave is to be continued as a separate payment from income support for mothers and families facing poverty, it should be justifiable on the grounds that it generates a positive externality, and that the benefit to society exceeds the cost. Therefore the extent that a subsidy for paid parental leave (as distinct from unpaid parental leave, which exists independently of this scheme) is warranted, it can only be the marginal increase identified above that is relevant.[23]

The final relevant metric that allows us to assess the efficiency of the scheme is the cost. The 2011/12 portfolio budget statement for families, housing, community services and indigenous affairs noted that it expected 148,000 families would access Paid Parental Leave at an estimated cost of $1.35 billion for that year. [24] This cost was predicted to rise to $1.44 billion (and would rise further in the future as dad and partner pay came online). [25]

At a minimum, it should be observed that more than three-quarters of those eligible for Parental Leave Pay were already taking 18 weeks off after birth and any tangible benefit to society that would come from them taking parental leave is already being captured. For these women, however ‘deserving’ they are of support, PLP is not an incentive payment, it is a windfall gain. Moreover, for those women who would not have taken 18 weeks leave prior to the introduction of Parental Leave Pay, the clear majority would still not do so despite the introduction of PLP.

7.5% of 148,000 families who were expected to access Paid Parental Leave equates to just over 11,000 households who changed their behaviour as a result of the scheme. As the scheme cost $1.35 billion, this works out to be more than $120,000 to incentivize the desired behavior for each of those households, though even assuming each of those households claimed the full amount, they collectively received less than $135 million.

Parental Leave Pay also aims to encourage the re-entry of women back into the workforce after taking leave. The incentive in the policy here is much more straightforward: women must return to work between periods of maternity leave in order to be eligible for additional Parental Leave Pay for subsequent children. The evaluation found that 27 per cent of mothers had not returned to work within a year post the introduction of Parental Leave Pay, compared to 31 per cent of who didn’t return within a year prior to the introduction of Parental Leave Pay. Insufficient time has elapsed to allow conclusions to be drawn on the lifetime participation decisions of mothers as a result of this additional time in the workforce, and no evidence has been presented on what benefits would accrue to taxpayers from this additional short-term participation (noting the additional cost that would come from those women being entitled to additional Parental Leave Pay for the birth of subsequent children).

Similarly to the calculations above, the number of additional women returning to the workforce is less than 6,000, receiving at most $70 million in Parental Leave Pay payments.

This suggests that only $200 million of the $1.35 billion paid in Parental Leave Pay is effective in achieving goals 1 to 3 of Parental Leave Pay, and probably only half that — given the high likelihood there is substantial overlap between those taking longer parental leave because of the payment and those returning to work. The evaluation found minimal tangible impacts on the distribution of household work between men and women, or on mothers’ treatment at work while pregnant (which is how the review assesses the success of goal 4).

It may be that there are better ways to achieve these goals than through an ill-defined welfare payment, such as a more generous income-contingent loan scheme.

Personal future funds and lifetime income smoothing

Welfare payments for young families and retirees are sometimes justified on the basis of lifetime income smoothing.[26] This may be justifiable in terms of education, where substantial costs and debts could be incurred by children who have had no opportunity to build up income or savings to meet those costs. It is less justifiable for families with savings and incomes or pensioners (who have had their entire lives to save for retirement).

The lifetime tax welfare churn cycle was noted by Andrew Baker, who observed in 2013 that households in the 25–34 bracket and 45–54 age brackets are substantial net taxpayers but 35–44 and 65+ were substantial net recipients.[27] One thing that is not often noted is how this cycle is exacerbated by the compulsory superannuation system. Those in the 35–44 age bracket are often earning reasonable incomes, and their superannuation savings can amount to thousands of dollars a year. Yet as net non-taxpayers they are effectively deemed to have insufficient income to meet their needs. Why are they being compelled to save?

The issue of net taxpayers is another that excites a lot of misdirected energy. There is a legitimate issue if large numbers of people are withdrawing more from the system than contributing to it, but the bigger questions need to be asked: is lifetime income smoothing a role that government should play? Is there a better way to achieve the same outcome?

Treating superannuation as a personal future fund, a vehicle for personal lifetime income smoothing, could have two positive impacts. First, it would give people an interest in their superannuation in their 30s, as they could access it to offset childcare and family costs. Second, government payments for childcare, family tax benefits and potentially other payments, could be substantially reduced. As long as those withdrawing money from super had a chance to catch up contributions later in life (when they are net taxpayers and therefore better able to afford retirement saving), there should be at best minor detriment to the superannuation system.

In a way, this simply brings superannuation into line with other assets. It makes very little sense from the perspective of taxpayers to make welfare payments to those with substantial assets they can't or won't use to support themselves. The other obvious example of this is the family home.

A precis of pension reform[28]

At more than $44 billion this year, the age pension is the largest single payment made by the federal government, exceeded only by combined grants to state governments. Annual expenditure is predicted to exceed $50 billion before the end of the decade.[29]

The 2009 Pension Review by Harmer found that the purpose of the age pension is to support those who cannot support themselves, meaning it fits squarely in the classic sense of a welfare payment. [30] Yet the pension is viewed by many retirees as an entitlement payment — a reward for working hard and paying tax during their employed years.

This view, despite being strongly held, is not correct.

In practice, the means test makes the pension quasi-universal. Between 70% and 80% of retirees receive some form of pension, a significant increase in pension coverage since the introduction of the pension.

This has occurred at the same time as the value of the pension as a percentage of wages has been steadily increasing by government policy. It is hardly surprising there has been a big increase in real terms. Indeed, in the past 40 years the cost of the pension has significantly outstripped wages growth — it has doubled as a percentage of wages over that time.

It might be supposed that the maturation of the superannuation system would alleviate the cost increases and ensure that the pension system remains sustainable. However, due to the generous limits on the means test (which have increased from 12 times the maximum payment to nearly 35 times the maximum payment), this will not be the case. In fact estimates suggest that the maturity of superannuation will result in only an additional 3% of retirees being independent of the government pension, and the costs of the pension being reduced by only 6%.[31]

As a consequence, the recent Intergenerational Report predicts that the cost of the pension will be more than $150 billion a year in 40 years time.[32] This will occur at the same time as the ratio of workers (taxpayers) to retirees significantly declines. Currently there are 4.5 workers paying taxes to support each person in retirement. By 2055, this figure will be just 2.7. [33]

While there is little doubt this represents a policy failure in superannuation, there are other reasons to think there are policy failures in the design of the age pension. More fundamentally than this, though, is that it is unfair. It's unfair to future generations who will pay, but not get a commensurate benefit.

A recent HILDA report demonstrated that over the last decade, the biggest wealth gain accrued to retired couples and singles.[34] Young families have seen no real gain in their wealth over the decade. This is almost entirely down to significant increases in house prices, so it should not be a surprise that housing is a key plank in the 'generational war'.

At the same time as the main welfare payment to retirees has significantly increased, the value of their main asset has increased at the same rate.

The exemption of the family home from the pension means test provides an enormous benefit to retirees whose biggest asset is their home. Consequently, there has been a massive overinvestment in housing by pensioners, with 70% of pensioners holding three-quarters of their wealth or more in their home.

This exemption discourages pensioners from downsizing, as capital released from the sale of the home is included in the pension means test. It contributes significantly to housing affordability problems. It also makes the pension means test unfair to pensioners who don't own their own home.

This is clearly evident from the fact that full-rate pensioners who own their home have 9 times the net worth of those who don't. As a consequence, tens of billions of dollars are being used to provide income to those who could support themselves. Including the family home in the means test, together with an expansion of the reverse mortgage market backed by government guarantees, could see savings of nearly $15 billion a year, and a boost of almost $6,000 a year in additional income for 98% of pensioners.[35]

Welfare recipients are individuals

One problematic factor that is causing some of the growth in welfare spending is the broader tendency to group all welfare recipients as homogenous categories rather than dealing with them as individuals with disparate circumstances and need. There is no doubt some retirees are vulnerable to poverty and in need of income support. It is also true that retirees as a group have lower incomes than those working. However, this does not mean all retirees are vulnerable and in need of assistance. By identifying that some recipients of a payment are in need of greater assistance, and using that to argue for an increase in the base payment, those in favour of an expanded welfare state ratchet up costs.

People do not need welfare because they are old, or indeed because they are unemployed, or disabled, or single mothers. These categories may be a contributor towards, or even the dominant cause of, poverty but it is the poverty itself that is the trigger for welfare assistance.

This is important not only from the perspective of reducing the cost of welfare but also the lifetime impacts of welfare dependence. As membership of many categories that receive welfare assistance is not voluntary (age and disability) or not always within the control of the recipient (single motherhood), it could encourage passive welfare receipt. It fosters the belief that membership of a particular category entitles someone to welfare payments, even if that person does not objectively need income assistance.

Those advocating for increased assistance to Indigenous Australians, or women, are obvious examples of this tendency. However it is also apparent in the attempts of others to equalise the expenses of families with couples and singles without children through childcare and family payments.

By focusing on need, and on encouraging welfare recipients to take independent action to alleviate that need, welfare functions as a safety net as it should. For many, this means securing employment. However, for pensioners this means unlocking their saved wealth and converting it to income.

Conclusion — shrink the welfare state by combatting poverty

For too long, those promoting the need for welfare reform on the basis of cost have focused on the wrong elements of the system. In some cases, they have advocated tightening eligibility for unemployment benefits and single mother payments while simultaneously increasing the scope and cost of family benefits and pension payments.

The attitude that the problem is 'dole bludgers and welfare cheats' will never result in sustainable welfare reform. The only realistic method of reducing the size of the welfare state is to refocus the existing payment system on need. By cutting payments to the middle class, to families and to pensioners with substantial net worth, and using some of the proceeds to boost payments to those genuinely in poverty, it will be very difficult for welfare advocates to object to the reforms.

This will mean abandoning forever the distinction between deserving and undeserving welfare recipients. In truth, however appealing such a distinction might be, it has proved impossible to constrain the welfare state by limiting growth of payments to the so-called undeserving. Not only have these attempts, like the Abbott government's proposed restrictions on access to Newstart, proven to be politically impossible, but the growth in payments to the 'deserving' through childcare and age pensions has overwhelmed any savings that might have been found.

The safety net should be robust (perhaps more so than now in some areas) but should only be available for those who are in genuine need. Government welfare should not be a vehicle for redistributing income in order to create a utopian, 'equal' society, or to cushion the vicissitudes of life.

In practical terms, this approach means payments like family tax benefits, the age pension, childcare benefits, paid parental leave, and potentially others should be substantially redesigned, with significantly more restrictive means testing. Consideration should be given to using superannuation funds for lifetime income smoothing, rather than tax welfare churn. Payments such as single parent benefits, and unemployment benefits, may also need to be recast, with a focus on participation but also potentially with higher base payments to ensure the recipients are not condemned to poverty.

The overall effect of this redesign is that the system should cost less, but provide greater assistance to those who really need it. Neither side in the debate will be happy, but nor will they have much cause for unhappiness — which seems more important in the current political environment.

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