

# NZ Centre for Political Debate Forum



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The New Zealand Centre for Political Debate

## Welfare Reform in Australia

Australia has been going through an unprecedented and unbroken period of prosperity. The economy is booming, employers are complaining of labour shortages, and real incomes are higher than they have ever been. Yet rates of welfare dependency are still rising.

Forty years ago, just one in thirty working-age Australians drew their income wholly from welfare benefits. Today, one in six working-age adults lives wholly off welfare, yet real incomes are double what they were in the 1960s. Include those receiving a partial payment and the dependency rate rises to more than one in four.

And this is just the tip of the welfare iceberg. The great majority of Australian families are today receiving government payments of one form or another. Families earning over A\$100,000 per year claim Family Tax Benefit (Part A), and even millionaire families qualify for Family Tax Benefit (Part B), which is paid to all families with only one earner.

Nor does it stop there. All workers have a portion of their income compulsorily diverted (via their employers) into personal superannuation funds which are meant to provide an independent source of income in retirement. But despite this, the means-tested age pension is still claimed by more than four in every five retired Australians (more than half get a full pension, and over a quarter get a reduced one, depending on how much other income they have coming in).

The cost of supporting all these people is enormous. In 2003-04, A\$80 billion was spent on income support. More than a quarter of this was soaked up by age pensions. Family payments took another A\$15 billion. And payments to working-age claimants included A\$8 billion in disability support payments,

A\$6 billion to support non-working parents (usually single parents), and A\$5 billion in unemployment allowances.

In the same year, the total amount collected in personal income tax was just over \$90 billion. In other words, almost all the money paid in income tax by working Australians was used to finance government transfer payments.

Much of this money represents a transfer from those who are working to those who are not. But some of it finds its way back to the same people who cough up the cash in the first place. Many families, in particular, find the tax deducted from their wages gets recycled into the various payments they receive from the welfare bureaucracy.

The government likes to claim that this 'churning' of money between the tax and welfare systems means that low and middle income families pay no tax, but this is misleading. Like most other working Australians, they pay a lot of tax, but unlike

workers without dependent children, they then receive a lot of it back.

One of the big debates raging in Australia at the moment is whether this matters. The Howard government likes to boast about how it has helped families, and it is true that families with children have been showered with cash in recent years. Not only do they get the Family Tax Benefit, but special payments of \$600 per child got thrown at them in the run-up to the last federal election, and the government has also introduced child care allowances to go along with child care benefits. What ministers do not say, however, is that many families are paying for their own benefits.

There are two main reasons why this matters. The first is that it pushes up marginal tax rates. Even if people eventually get their tax back again in one form or

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another, the size of the government budget needed to finance all this activity necessitates dauntingly high marginal rates of tax. This creates significant work disincentives every new dollar of tax raised by the Howard government is now taking at least \$1.20 out of the economy because of the 'deadweight losses' associated with reduced economic activity.

The second reason why extensive tax-welfare churning matters is it encourages people to think they cannot look after themselves and that they must instead rely on the government. Those Australian families paying hundreds of dollars of tax each week and then claiming it back on benefits and payments could get by perfectly well without any government help, if only the government did not take so much tax off them in the first place. A dependency culture is not only created by extensive welfare benefits it is also generated by high taxes.

There is little sign at present that the Howard government is interested in reducing tax-welfare churning. Handing out money is a tried and tested method for politicians to win votes and get themselves re-elected, and not many Australian voters realize that they are being bribed with their own money. As we move towards this year's federal budget, all the indications are that even more money will therefore be 'given' to families the pressure to increase subsidies for those using pre-school child care is particularly intense, and the Treasurer is unlikely to have the desire or will to resist it.

Nor is there much sign of the government doing anything significant to reduce dependency on the age pension. Three years ago the government published its "Intergenerational Report" which warned of falling revenues and increasing expenditures as the population ages. The biggest problem will be health care costs, but there will also be many more retired people than there are today. Recent forecasts predict that three-quarters of them will still be claiming a full or part pension in the year 2050.

The real problem is that, having made personal superannuation saving compulsory, the government cannot resist the temptation to tax it (super taxes now provide 3% of all government revenues). Australia is the only country in the western world that taxes superannuation three times: when it

is paid into a fund, when the fund makes profits, and when income is withdrawn on retirement. The result is that savings grow more slowly than they should and workers lose out on the advantages of compound interest. Pressure is building on the Treasurer to scrap the 15% tax on contributions, but nobody is holding their breath.

Where the government has been active, however, is in attempting to reduce the scale of dependency on benefits for working-age people who do not work. As in New Zealand, there are three main categories of such claimants single parents, the unemployed and those claiming to be incapacitated.

Changes in the conditions governing unemployment benefits began under the last Labor government, but reform was intensified under Howard. Now, anybody under the age of 50 who has been claiming unemployment benefits for six months must undertake a 'mutual obligation' activity (normally for 2 days per week). This could involve retraining, or community activity, or so-called 'Work for the Dole.' This policy was highly controversial when it first came in, but it is now widely accepted, although critics sometimes complain that Work for the Dole schemes do not adequately prepare people for proper employment.

The continuing problem in the unemployment benefits system is the persistence of 'long-term unemployment' (defined as people out of work for a year or more). Half the people who become unemployed find another job within eight weeks for them, welfare is a transitory experience. But 18% of the unemployed (almost 100,000 people) are long-term, and many of them appear to have become habituated to joblessness. They go through their six month stint of mutual obligation, then go back into the system for six months, and then do another round of mutual obligation, by which time the whole process has become a meaningless ritual. The only way to stop this is by introducing time limits, but the government has shown no inclination to take such a step.

For many of the long-term unemployed, unemployment ends by getting reclassified as 'disabled' and going onto the Disability Support Pension (DSP). As in New Zealand, the numbers of people claiming welfare on grounds of incapacity has

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mushroomed in Australia, even though the population is fitter and healthier than ever before. The two biggest categories of disability are 'musculo-skeletal' and 'psychiatric-psychological' conditions, both of which are so broad as to cover the whole range from full incapacity to minor ailments.

If you are unemployed, there are several advantages to getting yourself reclassified as 'disabled.' One is that people on the disability pension do not have to undertake any mutual obligation activity. Another is that the rate of payment is higher. Once on the DSP, very few ever return to active labour force participation.

The New Zealand government hopes to reduce the drift into 'disability' by abolishing different categories of payments and herding all claimants into the same umbrella benefit. This will have the advantage of greater flexibility instead of having to classify people as either capable or incapable of working, claimants will be assessed on a case by case basis and expectations will be amended accordingly. The downside of this solution, however, is that it will hugely increase bureaucratic discretion, and the system will lose clarity. At the moment it is clear what the expectations are when a claimant enters the system (unemployed people, for example, know that their claim is temporary and they are expected to return to work). Moving to a single payment means this categorical clarity will be lost.

Australia has taken a different tack. Instead of abolishing the categories, it is trying to sharpen the criteria that distinguish them. It is, however, notoriously difficult to do this.

Even though it is widely known that many perhaps most existing disability claimants could work, governments encounter huge opposition when they try to take effective action to reduce spurious claims. When the Blair government tried to tighten up the rules in 1997, for example, the UK Parliament was besieged by wheelchair demonstrators, even though many of the demonstrators would have benefited from the changes (for if payments are limited to those who are genuinely incapacitated, there is more money to go round). Similarly in Australia, the Howard government met with strong resistance when it suggested tightening the definition of disability, but when the Liberal-National Coalition unexpectedly won control of the upper house as well as the lower in the 2004 federal elections, it was able to push the changes through.

The basic change is that incapacity will now be

defined as in inability to work 15 hours per week (3 hours per day). Previously it was 30 hours. Anybody claiming benefits who is deemed capable of working 15 hours per week will from now on be treated as 'unemployed' rather than 'disabled,' which means they will be subject to mutual obligation requirements and will receive a lower level of payment (this change does not apply to those who are already on the DSP). The result should be to reduce the flow of new claimants into DSP (probably at the expense of increasing the official unemployment rate, at least at the outset).

Critics of this measure have accused the government of being 'uncaring,' but an even bolder change has been made to the eligibility rules for Parenting Payment (Australia's equivalent to the

Domestic Purposes Benefit). As in New Zealand (but in contrast with almost every other western country), single parents have hitherto been entitled to stay out of work and claim welfare support right up until their youngest child reaches the school-leaving age. This is not only absurdly generous by international standards (in most European countries, single parents are expected to return to work, at least part-time, by the time their youngest child starts school or

even pre-school); it is also hugely counter-productive, for it encourages the sort of long-term welfare dependency that destroys skills, undermines self-confidence and guarantees poverty. One Australian study has found that single parents living on Parenting Payment spend an average of twelve years on benefits, by which time they have become almost unemployable.

The government's preferred answer was to require new Parenting Payment claimants to work part-time once their youngest child turned six years of age (as with the DSP changes, the new rules would not apply retrospectively to existing claimants). However, this proposal met with predictable uproar with single parent groups, welfare groups and opposition parties all howling about the unfairness of expecting single parents to work part-time while their children are in school. Opponents focused on the financial implications for jobless single parents with older children who would in future receive unemployment benefits rather than the more generous Parenting Payment. It apparently did not occur to these critics that the point of the change was to get these parents off benefits and into jobs, in which case their incomes would rise, not fall

Buckling under the political pressure, the Howard government backed off slightly, announcing

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that some parents (e.g. those with large families or living in remote areas where jobs are scarce) will be exempt from the new work requirement, and that the age of the youngest child at which the parental work requirement will begin would be raised from six to eight. This means parents with children under eight years will still be entitled to stay at home all day on welfare benefits, even though their children are in school. Notwithstanding these concessions, however, an important principle has been established: from now on, you will be expected to contribute to your own upkeep if you are no longer caring full-time for dependent children.

Summing up the Australian welfare changes, it is clear that while reforms are under way, this is no revolution. The government will continue to spend huge sums on income support well into the future, and millions of Australians who are quite capable of looking after themselves will continue to be cared for by the taxpayer. Taxes levied on people's incomes will continue to be onerous and the interaction of the tax and benefits systems will continue to generate all sorts of perverse incentives.

We have to acknowledge, however, that welfare reform is inherently difficult. Precisely because so many people now benefit from hand-outs, it is politically hard to scale the system back. All western countries have seen disability payments blow out, for example, and none has yet found a solution. Many also have a problem with long-term unemployment.

Can New Zealand learn anything from the Australian experience? Certainly it can take heart from

the reform of support for single parents which is popular, sensible and fair, and which in time should raise rates of workforce participation among this group of claimants. It must be a matter of regret that the work-testing of the Domestic Purposes Benefit in 1999 was reversed by the incoming Labour government.

Longer term, New Zealand might also revisit the issue of personal superannuation, for with an ageing population, an open-ended commitment to pay a non-contributory age pension to anyone who has failed to save for their own retirement looks little short of reckless. True, the NZ Superannuation Fund is putting aside \$2 billion a year to save for the cost of future pensions, but at its peak this will only cover about 14% of the cost. More importantly, government savings initiatives like this discourage personal savings and undermine personal responsibility by reinforcing the message that you don't need to worry about saving, the government has it all under control. This is no substitute for encouraging or even requiring workers to put aside a portion of their earnings to help fund their own old age.

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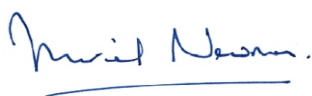
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Regards



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(founder & director of NZCPD)