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THE WELFARE STATE DEBATE:
ECONOMIC MYTHS OF THE LEFT AND THE RIGHT
F.H. Gruen
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ECONOMIC MYTHS OF THE LEFT AND THE RIGHT
By F.H. Gruen

Australian National University

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F.H. Gruen*

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* I would like to thank Bill Merrilees, Jonathan Pincus, Peter Stricker, Trevor Swan, members of the Development Division, Department of Social Security, for help at various stages in the preparation of this Lecture. Ms Lyn Gallagher provided valuable research assistance.
Introduction

It is a great honour to be asked to give the Giblin Lecture. It commemorates a very humane, able and yet unpretentious member of our profession. Lyndhurst Falkiner Giblin died in 1951 - some four years after I completed my B.A., B.Com. at Melbourne University. I recall Giblin delivering three or four papers, starting with his 1943 Melbourne University Extension Lecture on the problems of maintaining full employment. We were, I suppose, a fairly irreverent group who had little esteem for many of the heavyweights in the profession. However I recall our having a great deal of respect for Giblin; for his intellectual capacity, for his intellectual integrity and for his commonsense.

I have not examined Giblin’s writings for his views on welfare issues. One thing Giblin believed was that there existed a consensus in Australia for policy aiming at the greatest real income per head subject to inequality of incomes not being excessive. Also he once described an economist as a person who keeps his personal inclinations in the background and tries to state the facts impartially. It is in this spirit that I have attempted to draft this lecture - though I realize that the notion of impartiality has gone out of fashion with poke-bonnets, and that non-excessive inequalities is a beautifully imprecise notion.

* * * * *
In Australia, as in many other countries, the welfare state debate is a complex and many-sided one. To make my task more manageable I shall restrict my discussion of Welfare State debates to transfer payments - i.e. the payment of a wide variety of pensions, of unemployment benefits and so on. I shall leave to one side health and education debates which are often conducted separately.

I am using the term "economic myths" to suggest not only some completely fictitious perceptions, but also the notion of half-truth, of the selection of those "relevant" facts to portray economic reality which bolster one's general political stance. Thus the Left, believing in planning and the political seizure of the so-called "commanding heights" of the economy, is impressed by the concentration of private power in the economy. It regards the economy as dominated by such concentrations. The Right on the other hand believes in the maximum possible freedom for economic agents. It envisages the economy as an essentially competitive one - a view which fits in better with economic liberalism and non-intervention. One's picture of economic reality seems to depend on how one would like to perceive it.

Selectivity of perception is of course not a new discovery. Long before psychologists studied the selectivity of perception resulting from the emotional character of the stimulus, Shakespeare's Henry IV spoke of "Thy wish was father, Harry, to that thought". Nevertheless, surprisingly little attention is devoted in Australian economic writings to this phenomenon of selectivity - and to the differing policy stances associated with
it. For an exception I would refer you to Eric Russell's classic Presidential Address to the Economics Section of ANZAAS a decade ago in which he attempted to disentangle some of the elements in the then topical debate on foreign investment policy – with the aim of identifying those matters of theory and fact where an economist might speak with some special authority.¹

My aim today will be to examine another current area of economic debate in a probably inadequate attempt to imitate Eric Russell's aim of identifying those matters of either fact or theory where an economist can make a useful contribution.

My title speaks of "the Right and the Left". During the 'fifties and 'sixties, that dichotomy was regarded as being outdated and simplistic. At that time social critics such as Crossland, Galbraith, Myrdal and Bell wrote of the rise of legitimate meritocratic elites, of increasing internal harmony, of "The end of Ideology" and of the unimportance of distributive issues. However, the harsher economic climate of the seventies has, I would argue, restored the prominence of these divisions. Right and Left are obviously relative labels – varying with the substantial issues of debate both over time and between countries. However, egalitarianism and similar distributional issues are one of the permanent underlying ingredients in these controversies.

The Welfare State debates I shall examine are four in number. There is firstly the issue of the adequacy - or meanness - of the social security provisions made by government, and secondly, the issue of incentives or, more broadly, the behavioural effects of changing levels of benefits. Thirdly, there are the redistributive effects of welfare provisions. Are they - as sometimes alleged by the Right - largely random (or even worse do they benefit mainly the "middle classes") or do welfare provisions reduce poverty and hardship? Finally given existing demographic trends and the increasing take up of social security benefits by those eligible, is the existing social security programme a sustainable one over the long haul?


To establish the adequacy, or meanness, of Australian social welfare provisions, three kinds of comparisons are normally used - international comparisons, comparisons of social welfare benefit levels with the poverty line, and estimates of changes in inequality. None of these assessments is entirely satisfactory - though some are less so than others.

2 In singling out these four issues for discussion, I do not mean to imply that others, such as selective versus universal payments, the replacement of the existing arrangements by a guaranteed minimum income scheme and similar controversies are of lesser importance or of intellectual interest. However the opposing sides in these debates are less identified these days with different general political stances.
The easy international comparison - of expenditure on welfare as a percentage of GDP - is a particularly poor way. It focusses on gross expenditures and thus ignores relative needs. For instance, almost half the Australian social security bill is used for paying old age pensions; yet the proportion of the aged in different countries varies widely. In Britain and in Germany it is some 60% higher than in Australia. Hence if this were the only expenditure incurred, Britain and Germany ought to spend some 60 per cent more than Australia - without Australia being any meaner towards its aged.

An equally important reason why such comparisons are to be treated with scepticism is that Australia has a social security system based on flat rate benefits. As a result, a much higher percentage of social security payments is directed to those in need than in earnings-related benefits based on insurance-type contributions which are the norm in other OECD countries.3 Basically, the relative level of direct government expenditure tells us little about the adequacy of that expenditure relative either to welfare needs or to community standards.

If we compare expenditure on specific functions or relative benefit levels in Australia and in other countries, Australia seems usually to be a laggard among the welfare states. Of the four international comparisons I have been able to unearth, three suggest that Australian "generosity" compares very unfavourably with other OECD countries. One relates to unemployment benefit

3 Again differences in tax treatment, subsidies to living costs (e.g. rate and rental rebates in Australia, food stamps in the US) are ignored.
levels for single persons as a percentage of the average wage. Out of nine OECD countries, Australia has by far the lowest level.4

Second, a recent cross-national comparison of social service pensions for the elderly by P.K. Kaim-Caudle suggests that, after allowing for the different proportions of the aged in the population, Australia's expenditure on social service pensions is the lowest of six OECD countries (though this time not by a wide margin).5

Third, a recent US study by Haanes-Olsen of old-age benefits and average wages in a dozen countries can be used to make a comparison with Australia. In Australia the old age pension was some 22.9 per cent of average weekly earnings in 1976 (since then it has risen marginally to 23.8% - i.e. for June 1980). But even this higher, more recent figure is lower than pensions as a proportion of earnings in all the twelve countries studied by Haanes-Olsen.6 The only relatively favourable international comparison I have encountered relates to the unemployment benefits payable to a married man supporting a wife and two

4 Source: OECD, Income Maintenance Expenditures in Selected Countries, July 1974, p.12-13. The relevant figures are: Denmark 65.4%; France 56.9%; Germany 64.3%; Netherlands 88.8%; Norway 38.9%; Sweden 82.6%; U.K. 38.4%; US 52.2%. The figures relate to 1972. For Australia the percentages are 16.9 for December 1972, 21.1 for March 1980 and 18.1 for June 1981.

5 SWRC Reports and Proceedings No. 14, September 1981, Social Welfare Research Centre, University of New South Wales, Table 5, p.43. The countries and the corrected expenditures on social service pensions for the elderly as a proportion of National Disposable Income are: New Zealand 7.5; Australia 3.2; Britain 3.5; Canada 3.5; Germany 5.9; US 3.8. The figures relate to years from 1977 to 1980.

6 See foot of following page.
children. Here the Australian benefits - as a proportion of the average wage - were more generous than those in four other OECD countries (out of a total of nine possible inter-country comparisons). 7

Poverty research, and in particular, the estimation of the number and types of persons falling below a poverty line represents, at first glance, a fruitful way of looking at the adequacy of social welfare provisions. Regrettably, poverty research has not been successful in providing us with clear criteria for identifying "poverty" - granted that poverty can be defined consistently only in terms of relative deprivation. The English poverty researcher Townsend seems to have established a non-arbitrary standard of relative deprivation. 8 But this requires a good deal more testing - let alone application to Australian conditions. The Henderson poverty line frequently

6 "Earnings Replacement Rate of Old-Age Benefits 1965-75, Selected Countries", by Leif Haanes-Olsen, Social Security Bulletin, January 1978. Pensions as a percentage of earnings for different countries in 1975 were: UK 26, Denmark 29, Switzerland 36, Netherlands 38, USA 39, Canada 39, Norway 41, France 46, Germany 50, Austria 54, Sweden 59, Italy 67. Of the countries listed the UK and the Netherlands provide flat rate benefits only; the others use earnings-related or two-tier old age benefit provisions.

7 House of Representatives Hansard, 25th September 1979, p.1523. The comparisons were Australia 54.8%; Austria 46.8%; Belgium 60.0%; Canada 66.5%; France 48.3%; Germany 58.3%; Japan 68.8%; Netherlands 90.0%; Norway 44.2%; UK 67.3%. The comparisons relate to 1974. Comparisons are also available in the same answer for nine US states; Australian married unemployment benefits were more generous than those for six of the nine states listed.

used in Australia is widely recognised by both Right and Left as being arbitrary - which really makes it an inadequate standard against which to measure the adequacy - or the meanness - of Australian social welfare provisions. It does however provide useful information about which groups are most at risk of poverty and thus assists in setting expenditure priorities.

Nor has the updating of the poverty line provided a more reliable indicator against which one can measure changes in the adequacy of social welfare provisions. Updating of the poverty line seems to have been fraught with as many difficulties as its original determination. Thus the most recent and perhaps most thorough updating of the Henderson estimates of numbers in poverty by the Social Welfare Policy Secretariat (SWPS) points out that its estimates are highly sensitive to various assumptions about relative needs and should not be treated as indisputable. The SWPS estimates that while the percentage of adult income units with incomes below the poverty line has fallen since the early seventies, the proportion of people in poverty has fallen, if at all, only slightly.9

The composition of the poor seems to have changed. Widespreadly there are more unemployed and more sole parents, whilst the relatively higher pensions and benefits in the late seventies would have reduced the proportion of aged and those

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9 "Report on Poverty Measurement", Social Welfare Policy Secretariat, August 1981, AGPS, p.175. This conclusion appears to be slightly optimistic, in the light of the evidence adduced that the proportion of people in poverty had increased by 16% compared to Henderson's 1972-73 estimates and fallen by 5% compared to Beckman's alternative estimates relating to 1973-74.
with three or more children who are poor according to the poverty line.

Have the seventies seen a great increase in inequality - as is sometimes suggested on the Left? The Australian Bureau of Statistics has conducted three income distribution surveys since the late sixties which provide us with a good deal of information on changes in Australia's income distribution. The surveys took place in 1968/69; 1973/74 and 1978/79. Over this period there have been some major social and economic changes in Australia. First, there has been a major increase in unemployment (1.4% of the workforce were unemployed in 1968/69; 1.8% in 1973/74 and 6.2% in 1978/79). Second, the equal pay decisions of the Arbitration Commission have led to a substantial increase in the relative income of women. For instance the median income of full time women workers has risen from 60% of that of full time men in 1968/69 to 77% in 1978/79. Thirdly there has not only been an extension of social security benefits to some new groups such as single parents, but also an increase in many benefits relative to other community incomes.10

10 For detailed comparisons of changes in social security pensions and benefit rates with changes in the cost of living and average weekly earnings see Podger, Raymond and Jackson, "The Relationship Between the Australian Social Security and Personal Income Taxation Systems: a Practical Examination", Research Paper No.9 (Dec.1980), Development Division, Department of Social Security, Canberra.
As a result of both the increase in unemployment and the improvement in social security benefits there has been an increase in the proportion of Australian income recipients whose principal source of income is social security benefits. There has also been an increase in the relative income of those relying primarily on social security benefits.

What have been the effects of these different factors on the inequality of incomes? That is an easier question to ask than to answer. What income units do we regard as the most relevant? What time period are we most concerned with? What measure of inequality do we regard as most appropriate – given that an increase in inequality is often an ambiguous statement? Again, how do we cope with the widespread avoidance of tax which probably affects people's answers to the Statistician’s questions about income?

You will not be surprised that neither I nor, I venture to assert, any other economist, has clear and unambiguous answers to these questions. However we can examine the evidence that exists and attempt to assess its uses and limitations.

11 The percentage of income recipients relying principally on social services has risen from 24% in 1968/69 to 29½ in 1978/79; with a particularly marked increase among males (from 7.3% to 15.0%). The dependence on social security has increased particularly among those over 55 years of age and those below 25 years. The average income of those relying primarily on social security benefits (as a percentage of all other income earners) increased from 16% in 1968/69 to 23.6% in 1978/79. Similar statistics can be produced for families. Thus the median income of families who receive 20% of their income from social service benefits has risen from 28.3% of the median income of all families in 1968/69 to 36.8% in 1978/79.
For some purposes we are interested in the income distribution among individuals. Feminists, for instance, have stressed that incomes are not equally distributed within families or other income units. Hence the distribution of incomes among individuals is of some concern. There is little doubt that the seventies have witnessed a substantial decline in inequality among individual income recipients. For example, the Gini coefficient (probably the most widely used measure to estimate the extent of inequality) of the individual income distribution among persons has declined from 0.47 in 1968/69 to 0.43 in 1978/79. An alternative measure sometimes used — aggregate income of the top quintile as a proportion of the bottom — has moved from 30.6 to 16.8. The lowest 20 per cent of income recipients have steadily increased their share of aggregate income — from 1.6% in 1968/69 to 2.0% in 1973/74 and 2.7% in 1978/79. These gains are partly the result of higher female wages, of the substitution of family allowances (payable to women) for tax concessions and rebates for children, higher social service pensions and no doubt also partly due to income splitting and tax avoidance!!

If we look at families and income units, the evidence is less conclusive. Both the Gini coefficient and the ratio of aggregate income of the top to the bottom quintile for families have moved in the direction of greater equality during the seventies. On the other hand the share of aggregate income going to the bottom 20 and 30% of families has been declining since 1968/69.
For income units we only have data for 1973/74 and 1978/79. They show a declining top/bottom quintile ratio (from 11.1 to 9.5) and an increasing share of aggregate income going to each of the three bottom deciles. However as David Ingleas has noted in a recent monograph, there have been some changes in definitions in the 1978/79 survey of families and income units so as to exclude some who changed their status during the year (e.g. by migration, by husband-wife separations etc.). "These exclusions appear to have drastically reduced the number of families/income units reporting nil or very low incomes, a factor which must be kept in mind in comparing the income distributions from the various surveys."12 In other words, the decline in the number of very low income units may be a figment of the Statistician's imagination.

A Preliminary Summing Up

Our overall verdict on the charge of the Left - that Australian social welfare provisions are very mean - must be one of qualified support. What international comparisons are available regarding relative levels of income support suggest that the Australian safety net is fixed considerably lower than the safety net in other countries. But it needs to be stressed that this is mainly the result of the nature of our social security system which is based on flat rate benefits - with a much higher percentage of social security payments directed to those on the lowest incomes than in earnings-related systems.

typical in most OECD countries. For a little known defence of
the Australian system, the reader is referred to an August 1983
paper by the late Professor Tom Brennan. Furthermore, certain
groups such as sole parents, the long term unemployed, and
unemployed school leavers are more generously treated in
Australia than under the typical contributory systems of most
OECD countries.

While the poverty line is largely an arbitrary device, it’s
updating by the Social Welfare Policy Secretariat suggests
that - at best - we have made no progress in reducing the
proportion of the population in poverty - using constant
definitions of relative needs. Given the increase in
unemployment and in sole parenthood, higher social security
expenditure seems mainly to have prevented poverty from getting
worse - rather than reducing either the poverty gap or the
proportion in poverty.

The Left’s complaint of a great increase in inequality seems
substantially overstated for the seventies. Incomes have become
more equally distributed among individuals - probably partly as a
result of income splitting for purposes of tax avoidance, but
mainly because of much higher relative pay for women and higher
social service benefits. Among families and income units the

13 "The Redistributive Function of Social Security - A
Contribution to the Discussion", by T. Brennan, Professor of
Social Administration, University of Sydney (mimeo). In this
paper Brennan attempts to rank countries according to
“progressivity” of both funding and of benefits. Brennan
seems to take a more sanguine view of “progressivity” of
income tax than seems warranted in the light of later
evidence.
evidence is less clear cut, with some indicators suggesting a move towards greater equality whilst others move in an opposite direction. As a minimum, up to 1978/79 from the published statistics there does not appear to have been any great increase in inequality of income.

However three provisos to this statement need stressing. Firstly published statistics on income may understate inequality to an increasing extent. Thus the self-employed have been avoiding an increasing amount of tax over the period we are considering here; hence their understatement of income may have increased pari passu. More importantly, there has been an increase in employment benefits over the years. Since these are partly tax avoidance devices, it is not surprising that they are more common among higher income earners. Here again "true" income inequalities are likely to be increasingly understated in ABS sample surveys of incomes which would find it difficult to value such benefits (and have so far not attempted to do so).

Second, trends since 1978/79 are likely to have reduced relative incomes of lower income recipients. Those social security pensions which are indexed, are indexed to movements of the CPI rather than of community incomes; hence one can expect a gradual erosion of such pension rates as a proportion of real per capita disposable incomes which are rising slowly (say by 0.5 to 1% per annum). More importantly, certain supplementary payments and unemployment benefits for single persons have fallen by 15% or more in real terms since 1978/79; at the same time average duration of unemployment has been rising. By the time the next
income distribution survey is due in 1983/84 relative pension rates which have been indexed will show a decline of 5 percentage points or so, whilst most unemployment beneficiaries will experience relative declines of 20 percent or more. Hence relative incomes of the lowest 20 per cent of income units can be expected to register a substantial decline.

Third, income distribution statistics need to focus on some units whose distribution one examines. With Australian statistics one can focus on individuals, on families, on households or on income units. Whatever unit is chosen necessarily represents an oversimplification of the actual degree of pooling of incomes or resources. Provided no major social changes are occurring, one might regard such oversimplification as providing some constant source of error. However, given the transition towards greater economic independence both for women and for adolescents and the trend towards single parent families such an assumption of constancy may be increasingly misleading. These trends towards greater economic independence denote an improvement in individual welfare which is completely ignored by concentrating attention on the distribution of income of some fixed groups - whether they are families, income units or households.

Welfare Provisions and Incentives

Judging by the amount of space devoted to the issue, those writing about Australian welfare policies do not attach much significance to the effect of changes in welfare provisions on
incentives. 14 Sometimes there are some references to the inconclusive nature of the various North American work incentive schemes - or to Okun's equality versus efficiency tradeoff. However there is no serious economic assessment of the behavioural effects either of welfare payments or of the taxes associated with growing social security transfers.

This is surprising. There is firstly a substantial international literature - dominated by US studies - of the effects of transfer payments on work effort, on savings behaviour and on the distribution of income. One recent survey article of that literature lists over 200 references. 15 In addition there is a growing number of contributions by Australian labour economists which suggest that social welfare benefits can have substantial behavioural effects. I shall provide a brief synopsis of some of the major contributions. These can be grouped into those dealing with the effects of unemployment benefits and those dealing with the effect of other pensions on labour force participation rates.


According to a 1988 study of unemployment beneficiaries by Gregory and Paterson, over the period 1979 to 1979 the response of the number on benefits when benefit payments rise is large. However, most of this increase comes from unemployed people who otherwise would not have taken up benefits. The increase in benefit payments has much less effect on total unemployment. If the real level of benefits had not changed over the decade, Gregory and Paterson estimate that the number on benefits would have been about 50 per cent lower. Total unemployment would have been 14 per cent lower.16

Another paper by Gregory and Duncan dealing with teenage unemployment, estimates that the increase in unemployment benefits for teenagers in the mid-seventies led to an increase in teenage labour force participation rates of between 5.5 and 7 percentage points and probably lowered school participation rates below the levels they would otherwise have reached. In addition, increasingly restrictive provisions for unemployment beneficiaries who engage in part-time work may have been responsible for causing part-time work to be done increasingly by those at school full time.17


Merrilees (1980) whilst finding the Gregory-Duncan hypothesis "extremely plausible" gives reasons for believing that the link revealed in empirical studies between unemployment benefits and male teenage labour force participation is largely spurious. 18 Merrilees own study finds evidence that changes in unemployment benefits have affected only school enrolment rates of 16 year old males (and these only marginally). No significant effects were found for 15 and 17 year old males and for 15, 16 and 17 year old female school participation rates. However a more recent note by P.A. McGavin obtains significant negative effects of increases in unemployment benefits on 16 year old male and female school participation rates. 19

Stricker and Sheehan's study of Hidden Unemployment in Australia used a variety of regression equations to estimate the amount of recession-induced usage of pensions in Australia. Some of these equations show that changes in the attractiveness of age, invalid and service pensions have also affected usage of pensions by males over the age of sixty. I am grateful to Dr. Stricker for performing a series of simulations - based on


19 W.J. Merrilees, "The Effect of Labour Market Conditions on School Enrolment Rates", Australian Economic Review, March 1981. P.A. McGavin, "School Participation of Australians Aged Sixteen: An Analysis of Youth Unemployment", Economic Record, Dec 1981, pp.379-381. Part of the difference between these two results is due to different definitions of the dependent variables; Merrilees used changes in the enrolment ratio of 16 to 15 year olds, whilst McGavin used changes in the enrolment ratio of 16 year olds over time.
his regression equations - to estimate the effects of the more attractive social security benefits which have been available after 1972. The estimated relative effects on pension numbers of both the depressed labour market and the higher social security benefits are given in Table 1. An examination of Table 1 suggests that both depressed labour market conditions and increases in social security benefits have had substantial effects on the proportion on pensions - with the high rates of unemployment being slightly more important.20

In a recent paper on "The Mass Exodus of Older Males from the Labour Force", Merrilees attributes most of the decline in participation rates of males over the age of 55 years to the increased financial attractiveness of social security benefits, though he regards this thesis as still "primarily exploratory".21 The labour force participation rate of the over-65 males declined by some 13 percentage points over the period 1964 to 1981 (i.e. from 23 to 10 per cent). According to a forthcoming study by Merrilees no less than nine percentage

20 P. Stricker and P. Sheehan, Hidden Unemployment: The Australian Experience, Institute for Applied Economic and Social Research, University of Melbourne, 1981, pp.83-93. I have some misgivings about Stricker and Sheehan's econometric use of unemployment duration as the proxy for labour market conditions. For instance, between 1979 and 1980 hidden unemployment should have declined - since the labour force participation rate increased. Yet the unemployment duration proxy suggests that hidden unemployment increased. However I have thought it desirable to use the Stricker-Sheehan equations. They have convinced many of the magnitude of the hidden unemployment problem. They can be used to show that behavioural effects of similar magnitude can arise from changing welfare payments.

### TABLE 1

An Estimate of the Effect of Increases in Social Security Benefits and of Depressed Labour Markets on the Usage of Pensions

<table>
<thead>
<tr>
<th>Year</th>
<th>60-64 year old males</th>
<th>Percentage on Service Pensions</th>
<th>Percentage on Invalid Pensions</th>
<th>65-69 year old males</th>
<th>Percentage on age, invalid &amp; service pensions</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Actual</td>
<td>Estimated Changes with constant</td>
<td>Actual</td>
<td>Estimated Changes with constant</td>
<td>Actual</td>
</tr>
<tr>
<td>1973</td>
<td>24.4</td>
<td>- 4.2</td>
<td>0</td>
<td>9.6</td>
<td>- 1.3</td>
</tr>
<tr>
<td>1974</td>
<td>27.0</td>
<td>- 4.8</td>
<td>0</td>
<td>10.3</td>
<td>- 1.2</td>
</tr>
<tr>
<td>1975</td>
<td>29.2</td>
<td>-11.2</td>
<td>0</td>
<td>11.2</td>
<td>- 1.6</td>
</tr>
<tr>
<td>1975</td>
<td>33.3</td>
<td>- 9.7</td>
<td>- 2.8</td>
<td>12.0</td>
<td>- 1.3</td>
</tr>
<tr>
<td>1977</td>
<td>36.5</td>
<td>-11.4</td>
<td>- 6.7</td>
<td>13.3</td>
<td>- 1.3</td>
</tr>
<tr>
<td>1978</td>
<td>41.8</td>
<td>-11.5</td>
<td>-10.4</td>
<td>14.6</td>
<td>- 1.2</td>
</tr>
<tr>
<td>1979</td>
<td>44.6</td>
<td>- 9.3</td>
<td>-15.2</td>
<td>15.2</td>
<td>- 0.9</td>
</tr>
<tr>
<td>1980</td>
<td>47.4*</td>
<td>-10.5</td>
<td>-16.6</td>
<td>15.0</td>
<td>- 0.9</td>
</tr>
</tbody>
</table>


*To interpret the table for instance 1980 figures. With 1972 service pension levels the percentage of 60-64 year olds on service pensions would be 10.5 percentage points lower i.e. 36.9%.

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points are attributable to more generous social security benefits. 22

** ** ** **

These different econometric studies should obviously not be treated as gospel. The mere fact that Merrilees on the one hand and McGavin, Gregory and Duncan on the other obtain different results with respect to school participation rates should act as a warning that the precision suggested by the numerical estimates is not justified. Again, there are significant differences regarding the effects of more attractive old age, invalid and service pensions on elderly male participation rates.

However there are a sufficient number of studies (both in Australia and overseas) to confirm economists’ prior beliefs about such phenomena - namely that an increase in welfare benefit rates can have fairly substantial effects both on the number claiming benefits and on the economic behaviour of potential claimants. This is true, in spite of our earlier conclusion that Australian levels of income support tend to be lower relative to community incomes than in most OECD countries.

In other words we are likely to be confronted with some efficiency/welfare benefit trade-offs. The situation can be likened to the moral hazard costs involved in insurance. Just as I am prepared to take out insurance, in spite of the administrative and moral hazard costs which represent a dead

weight loss, so we may rationally decide to provide more generous benefits which have some adverse effect on the potential output and real income of the community.23

It may also be possible to mitigate some behavioural effects of more generous benefits. For instance there is no reason why old age pension rates should not depend in part on the age at which people choose to retire. According to a study by Martin Tracy for the International Social Security Association, both early retirement (at a lower pension rate) and deferred retirement (at a higher rate) are fairly common features of retirement age pension provisions in many industrialised countries.24

Again, if incentives have the substantial behavioural effects they appear to have, the poverty trap and effective

23 I stress 'potential' here because one can mount a plausible argument that while the economy operates below its output potential, the only effect of, say higher age and invalid pensions which reduce elderly participation rates, is to reduce statistical unemployment without actually affecting the volume of output. But there are some possible counter arguments: (a) in spite of sizeable overall unemployment, there may be some isolated shortages of (experienced?) labour which could be aggravated by declining participation rates; more importantly (b) higher benefits are not easily or quickly reversible if and when the economy moves closer to its output potential - especially since the effect of higher benefits on participation rates are likely to be of a longer run nature (and may not be reversible).

24 M. Tracy, Retirement Age Practices in Ten Industrial Societies 1968-1976. Studies and Research No.14, International Social Security Association, 1979. However one should also record Tracy's conclusion that the effects of these provisions have so far been negligible in encouraging workers to defer taking up the pension. This could no doubt be remedied by increasing the incentives for later retirement (which ranged from extra pensions of 1-7.2 per cent per annum for each year of deferment in the countries studied).
marginal tax rates generally deserve both much more serious examination and administrative attention.25

The poverty trap results from the separate and independent imposition of means tests by different agencies of federal, state and local governments. In the aggregate these can raise effective marginal tax rates well above 100% - i.e. people’s disposable incomes are reduced as their pre-tax income rises. As a result of the interaction of pension income tests and the personal income tax system, pensioners in Australia may be subjected to marginal tax rates of 66 and 82% over wide ranges of income - i.e. higher marginal tax rates than the highest paid executive or professional worker whose lack of incentives are so often deplored.26 In addition, as their incomes rise, welfare recipients such as pensioners stand to lose a series of fringe benefits (including pensioners health benefit cards) which ACOS


estimated to be worth, on average, some $10-15 a week.27 Hence, for many welfare recipients, additional work effort can reduce disposable income over some - as yet indeterminate - range of non-pension income.

Space prevents me from dealing with other aspects of the relationship between welfare provisions and incentives. I refer to possible effects on savings and on family formation. Again taxes to finance transfers have their own incentive effects which have had to be ignored here.

The Welfare State as a Random Redistributive Device

Critics from the right sometimes suggest that the income redistributions resulting from the welfare state go to people who from any external characteristic are not particularly deserving. How true is this of the Australian social welfare benefit system? The answer is - not really. Poddar and Kakwani's pioneering study based on the Macquarie survey of 1966-69 established that cash benefits and transfer payments had a much greater equalising impact on income distribution than the income tax system at that time.28 An estimate made two years ago within government suggested that around 85-90% of Australian income security

27 The fringe benefits available to some welfare recipients include the pensioner health benefit card which entitles holders to free or heavily subsidised medical, hospital and optometrical benefits, free pharmaceuticals, 30% reduction in the basic telephone rental, free hearing aids and pathology services. During the recent Victorian State election campaign, pensioners received a 12 page pamphlet informing them of the benefits provided by the then State government. Such benefits include: a 50 per cent reduction of municipal water and sewage rates (up to $135 per annum); a 50 per cent reduction in motor registration and third party insurance; various public transport fare concessions; rent rebates, and a 75 per cent reduction in shooters licences!

28 See foot of following page.
expenditure goes to those below the poverty line and less than 5% to those with incomes above average weekly earnings. This would confirm one's a priori expectations - given the predominantly income or means-tested flat-rate Australian income security system.

A more recent study by Collins and Drane - based on the 1975-76 Household Expenditure Survey - suggests that Commonwealth Social Welfare Expenditure is somewhat more dispersed. According to the Collins and Drane study the 21 per cent of the population in the lowest income households receive between 57.5 and 68 per cent of all Commonwealth Social Welfare Benefits. Some of the voluminous data available from their study are reproduced in Table 2. It will be seen that - according to this criterion - old age pensions are more concentrated towards low income households than all Commonwealth Social Welfare benefit payments. Family allowances are spread fairly evenly among households, with only low income households underrepresented.29


29 Surprisingly, a substantial proportion of unemployment benefit payments are made to higher income households - especially those where the head of the household is below 24 or above 45 years of age. These estimates do not conform with other studies which suggest that unemployment is particularly concentrated among certain disadvantaged groups such as early school leavers, who might be expected to coincide with low per capita income households.
One great disadvantage of the Collins/Drane income classification is that it is not corrected for size of household. Hence low income households on average tend to have a smaller number of people and vice versa.

We also know that the lowest income recipients in Australia rely predominantly on social security benefits. Thus in 1978/79, 12.9% of all income recipients received less than $1,200 a year. Of these 1.2 million income recipients, 73.3% had social security benefits as their principal source of income. Similar statistics can be cited for families. The poorest 317,000 families in 1978/79 accounted for 8.5% of all families. 73% of these families received the bulk of their income (i.e. 60% or more) from social security benefits.

In addition one can produce suggestive evidence that the increases in social security benefits in the seventies have significantly raised the relative incomes of the poorest 20% of families. As a result of the growth of unemployment, of sole parenthood, of the progressive ageing of the Australian population (and of more generous social welfare benefits) the proportion of families with no income earners increased markedly in the seventies - from 8.4% in 1968/69 to 15.3% in 1978/79.

Families with no income earners tend to have the lowest incomes and to rely disproportionately on social security
TABLE 2
The Distribution of Commonwealth Social Welfare Benefits According to Household Income Class

<table>
<thead>
<tr>
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<tr>
<td>0 - 80</td>
<td>15.7</td>
<td>8.9</td>
<td>35.8</td>
<td>34.0</td>
</tr>
<tr>
<td>80 - 140</td>
<td>14.4</td>
<td>12.4</td>
<td>24.5</td>
<td>23.7</td>
</tr>
<tr>
<td>140 - 200</td>
<td>19.5</td>
<td>20.4</td>
<td>15.2</td>
<td>16.1</td>
</tr>
<tr>
<td>200 - 260</td>
<td>16.2</td>
<td>17.8</td>
<td>8.6</td>
<td>9.2</td>
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<tr>
<td>260 - 340</td>
<td>16.5</td>
<td>18.6</td>
<td>7.2</td>
<td>7.7</td>
</tr>
<tr>
<td>over 340</td>
<td>17.7</td>
<td>21.9</td>
<td>8.8</td>
<td>9.3</td>
</tr>
</tbody>
</table>

benefits. To isolate the effect of this particular change in the income distribution, one can estimate the 1968/69 income distribution with the 1978/79 distribution of income earners per family. Such a calculation suggests that the aggregate income share of the bottom 20% would have dropped from 6.8% to 5.9%. The actual aggregate income share of the bottom 20% dropped to 6.5%. It seems likely that this considerably smaller drop in the aggregate income share of the poorest twenty per cent of families has been the result of the more generous social welfare benefits available in 1978/79 than in 1968/69.

Similar, though more substantial evidence of the effect of welfare payments on poverty is available for the United States. The US survey by Danziger, Haveman and Plotnick referred to earlier, produced estimates that US income transfer programmes have reduced income poverty by some 75 per cent and income inequality by around 19 per cent. While similar estimates are not available for Australia, the evidence cited earlier suggests that similar orders of magnitude for the reduction of poverty might apply in this country.

30 The median income of families with no income earners was about 30% of that of all families in both 1968/69 and 1973/74 (30.4 and 29.9 respectively); by 1978/79 it had increased to 35%.

31 Danziger et al., op. cit., p.1019. As indicated on p.1006-1007 these redistributive effects are likely to be upper-bound estimates. However they are sufficiently large to suggest that transfers have reduced poverty very substantially.
Is the existing Social Security Programme a Sustainable One Over The Long Haul?

A good deal has been written recently in Australia suggesting that existing social security expenditures are growing more or less uncontrollably. Over the ten year period ended June 1979 Commonwealth income support expenditures grew annually at 1.7 times the rate of growth of gross domestic product. As a percentage either of the population or of the number of persons employed, government income support recipients have doubled over this same ten year period. These trends, plus the gradual ageing of the population, not to mention the political pressures for more generous benefits, electoral competition and the unpopularity of cutting back on social security benefits have all given rise to the notion that the momentum towards ever-growing government welfare budgets is well nigh irresistible.

Yet a closer look at the evidence suggests that these trends are both less inevitable and less “unsupportable” than the above considerations suggest. Firstly, the increase in the government’s social welfare expenditure is partly the result of the substantial deterioration of Australia’s economic performance. Unless one expects our economic performance to continue to deteriorate at the same rate, simple extrapolation
gives an unduly pessimistic picture of the likely financial burden. 32

Second, the claim that social security trends will impose an increasingly unsustainable burden ignores international experience. By comparison with other OECD countries, transfer payments are at a very low level in Australia (compared to total community income). Of twenty OECD countries listed in Table 3, only Portugal and Turkey make relatively smaller transfer payments. Australia's low place in this "pecking order" is the result of a number of factors discussed earlier — including the predominance of flat-rate income-tested benefits, the smaller proportion of aged and lower proportionate benefits. However, given that the economic performance of most of these OECD countries has been at least as good as Australia's, it is difficult to maintain that there is something unsustainable about the type of gradual increase in transfer payments which would be brought about by the progressive ageing of the Australian population — as it reaches the sort of age structure common in most western European countries.

Third, the relative expansion of Commonwealth Income Support expenditure is not proving quite as inevitable as the earlier scenario has suggested. After a steep rise in Commonwealth outlays on social security and welfare as a proportion of GDP

32 Another relevant consideration is that the proportion of the population aged 65 and over in receipt of an old age or a service pension has risen by some 48% over the ten years ended June 1979 (i.e. from 63.6% to 89.1%). Hence no similar percentage rise is possible in the next decade. Unless there is a general lowering of the retirement age, the proportionate increase in age pensioners must slow down in the eighties.
TABLE 3
CURRENT TRANSFER PAYMENTS IN 1978 AS A PERCENTAGE OF GROSS
DOMESTIC PRODUCT FOR SELECTED OECD COUNTRIES

<table>
<thead>
<tr>
<th>COUNTRY</th>
<th>PERCENTAGE</th>
<th>COUNTRY</th>
<th>PERCENTAGE</th>
</tr>
</thead>
<tbody>
<tr>
<td>Portugal</td>
<td>9.1</td>
<td>Finland</td>
<td>16.1</td>
</tr>
<tr>
<td>Turkey</td>
<td>10.5</td>
<td>Denmark</td>
<td>16.3</td>
</tr>
<tr>
<td>Australia</td>
<td>10.6</td>
<td>Italy</td>
<td>17.0</td>
</tr>
<tr>
<td>Japan</td>
<td>11.1</td>
<td>Austria</td>
<td>19.1</td>
</tr>
<tr>
<td>United States</td>
<td>11.2</td>
<td>Germany</td>
<td>19.6</td>
</tr>
<tr>
<td>Greece</td>
<td>12.3</td>
<td>Belgium</td>
<td>22.5</td>
</tr>
<tr>
<td>Canada</td>
<td>12.6</td>
<td>France</td>
<td>25.6</td>
</tr>
<tr>
<td>Spain</td>
<td>12.7</td>
<td>Norway</td>
<td>25.9</td>
</tr>
<tr>
<td>Switzerland</td>
<td>15.4</td>
<td>Sweden</td>
<td>29.2</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>15.5</td>
<td>Netherlands</td>
<td>31.7</td>
</tr>
</tbody>
</table>


(from 4.2% in 1971/72 to 8.2% in 1977/78) 33 federal income
support expenditure as a proportion of GDP has fallen steadily

33 These estimates are given in Appendix IV, Department of
They would exclude transfer payments administered by other
departments, e.g. Veterans Affairs, Education. This would
account for the differences in the percentages given here and
in Table 3. Part of the increase is the result of moving
from tax deductions and rebates for children to family
allowances. This occurred in 1976 and added some $800 million
to "outlays".)
for the next three years (to 7.6% in 1980/81).

In what areas has the present federal government reduced relative income support expenditures? To answer this question I have compared movements in maximum pension, benefit and supplementary assistance rates with those in community incomes. The comparison is between 1975/76 - i.e. the last financial year for which the Labor government prepared the budget, and 1980/81 - the latest year for which these figures could be compiled.

Over this five year period my measure of community incomes - i.e. household disposable income per head of population - increased by 65.1%. If all pension, benefit and supplementary assistance levels had been raised by 65.1% over the levels ruling during 1975/76, total federal income support expenditure would have been almost $1.1 billion - or 13.7% - larger than the actual 1980/81 expenditure (of $8.15 billion). 34 The savings made can be grouped into five major areas:

34 The savings given are lower bound estimates, since they do not make any allowances for increased uptake of pensions and benefits if rates had been increased in line with community incomes.
(a) $449 millions have been saved by freezing family allowances at 1976/77 rates; 35

(b) $237 million has been saved by freezing old age pensions for the over-seventies who do not meet the income test, at November 1976 rates;

(c) $193 million has been saved by indexing various pensions and benefits to the Cost of Living Index rather than to movements in community incomes;

(d) an extra $174 million would have been needed but for the tardy monetary adjustment to unemployment benefits for the single over 18 year olds, and lastly

(e) $65 million by freezing unemployment benefit payments to single under 18 year olds at $36 per week - i.e. the 1975 level.

Two features of the changing income support levels deserve further comment; first the largest savings have been made by freezing those payments which are not subject to means or income tests i.e. family allowances and age pensions to the over seventies who do not meet the income test. In that sense the government is already moving broadly along the line of concentrating assistance on the needy - a policy which many of its free marketeer critics on the right advocate.

Secondly, there is a marked contrast between the government's treatment of the unemployed and of other social welfare recipients. Whilst having shaved 3 to 5% off rates for other pensions over a five year period (i.e. by indexing according to movements in the CPI rather than community incomes and by neglecting to index various supplementary allowances), the government has been much more severe on single adult unemployed - whose real incomes have been cut by around 28% over five years. 36 It is difficult to see the rationale for this

35 Family allowances were only introduced in the 1976/77 financial year. For the third and subsequent children they were raised by 50% in the 1981/82 budget - at a full year cost of $124 million - or 13% of their 1980/81.

36 See foot of following page.
discrimination. As shown above, both the unemployed and those on
other social service benefits appear to respond to incentives.
Why is an old age or a service "pension bludger" any more worthy
than a so-called "dole bludger"?

More importantly, the greatly increased duration of unemploymen
in recent years has meant that it is much harder for
individuals to meet any part of their living expenses from their
own resources. A new entrant to unemployment now can expect to
be unemployed for nearly six months.37

Finally one needs to stress that what is supportable is
ultimately a political choice. The Left has a point when it
argues that expenditures on the relief of poverty are regularly
singled out as those areas where economies need to be made,
whilst other types of government expenditures or tax concessions
(which are in effect a form of tax expenditure) are regarded as
sacrosanct or even expanded.

36 Sixteen and seventeen year old single unemployment benefits
have been reduced even more; however one can argue that the
previous Labor policy of equating their benefits with those
of adults had undesirable consequences - given that the
incomes sixteen and seventeen year olds can earn in
employment are considerably lower than those of adults.

37 P.K. Trivedi and G.M. Baker, "Unemployment in Australia:
Duration Experience and Recurrent Spells", Centre for
ANU.
Thus the tax concessions for private superannuation schemes mean that a large part of superannuation income is not taxed either when it accrues as contributions or as investment income or when it is eventually received as benefits. In a recent submission to the House of Representatives Standing Committee on Expenditure, the Department of Social Security estimates the cost of private superannuation to the public revenue at around 1.9 to 2.4 billion dollars. This is roughly half the current cost of old age pension payments. Predominantly these concessions go to higher income earners; typically they amount to larger per capita subventions than are given to those who receive the old age pension. In many cases persons obtaining superannuation payments subsequently qualify for income-tested old age pensions by re-arranging their financial affairs accordingly. If we are concerned about the intolerable cost of government handouts, surely this double helping from government coffers needs to be attended to first of all.38

Apart from the question of what is sustainable or supportable in some economic sense, there is the equally important question of the willingness of the community to support welfare payments. Here there appears to have been a major change in attitudes. As Don Aitkin reported to the 1988 Summer School of the Australian Institute of Political Science, public opinion in favour of extra spending on social services has dropped dramatically - from 68 and 71 per cent in 1967 and 1971

38 This problem is addressed in the most recent publication of the Social Welfare Policy Secretariat, "Alternative Strategies to Meet the Income Needs of the Aged", AGPS, Canberra 1982.
respectively to only 36 per cent in October 1979. 39

Concluding Comments

The fundamental economic myths of the two sides in the welfare debate appear to me to be the following: On the Left an unwillingness to concede the effect of incentives on economic actions and to be scathing regarding the possibilities of any equality-efficiency conflicts. For instance Hugh Stretton regards the notion that greater equality may reduce incentives to work as scarcely worth taking seriously (and he certainly refuses to discuss it seriously). 40 This unwillingness of the Left in capitalist countries to admit the pervasive effects of both welfare payments and taxes on economic behaviour comes at a time when some economists in the socialist world are confronting the same problems with much greater realism. Thus the prominent Hungarian economist Janos Kornai's 1979 Geary Lecture was devoted to "The Dilemmas of a Socialist Economy". Kornai's fundamental dilemma turned out to be the conflict (dare I call it the internal contradiction?) between efficiency and the ethical principles of a socialist economy. 41


41 See foot of following page.
The major myth on the right is that any attempt to redistribute to the poor must be fraught with disaster. Thus the British philosopher and evolutionist Herbert Spencer wrote a century ago: "The command 'if any would not work, neither should he eat' is simply a Christian enunciation of that universal law of Nature under which life has reached its present height". 42 In a direct line of intellectual descent we have Friedrich Hayek's insistence that any public policy towards the redistribution of income and property is incompatible with a free society and the rule of law. Taking a dollar from a rich man and giving the proceeds to the poor man leads in some ineluctable fashion to the Gulag Archipelago. And most recently we have George Gilder's solution to the problem of poverty — that the poor must be driven by economic necessity to work harder and thus overcome their poverty.

The correct balance between the rival myths of the Left and the Right seems to me to have been struck by Arthur Okun in his 1974 Godkin Lectures at Harvard: "Abstracting from the costs and the consequences I would prefer more equality of income to less and would like complete equality best of all. This preference is a simple extension of the humanistic basis for equal rights... Nonetheless, my preference for one person, one income is not


nearly so strong as that for one person, one vote. Equality in material welfare has much lower benefits and far higher costs than equality of political and civil entitlements. While the provision of equal political and civil rights impose costs on society, the attempt to enforce equality of income would entail a much larger sacrifice. In pursuing such a goal society would forego any opportunity to use material rewards as incentives to production. Any insistence on carving the pie into equal slices would shrink the size of the pie. That fact poses the tradeoff between economic equality and economic efficiency.43

Estimating the costs of greater equality and, more importantly, finding ways to minimise these costs is an endeavour Australian economists have scarcely begun.