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**FINANCING SOCIAL SECURITY PENSIONS:
THE AUSTRALIAN EXPERIENCE**

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TABLE OF CONTENTS

	Page:
Preface v	
1. Introduction	1
2. The Australian social security system	3
The income support system	4
3. Historical overview	5
Introduction	5
1900-1910: The first steps - age and invalid pensions	5
The social insurance debates of the 1920s and '30s	6
The 1940s: Completing the picture - assistance to families, widows, the unemployed and the sick	7
The social insurance debate continues: 1950s-1970s	8
Social insurance rejected: The 1980s	10
Means tests on pensions: An enduring feature of the Australian social security system	11
4. Contributory and general revenue financing - a comparison	13
Limitations of the comparison	13
Features of social insurance (contributory) systems	14
Problems experienced by social insurance systems	14
Comparing the systems: Main criteria	15
5. Recent developments	23
The changing economic and social environment	23
The policy response	24
'Active Society' measures	27
Developments in occupational superannuation	29

6. Future directions and challenges: Australia	33
Simplification	33
Customisation of payments	33
Adequacy of payments	34
Broadening of community services	34
Financing the future	34
7. Summary and conclusions - lessons to be drawn from the Australian experience	35
Appendices	
1. Social security and tax	39
Taxation status of social security payments	39
Effective marginal tax rates	40
Differences in assessment procedures	40
2. The Australian social security system: A brief description of the main payments	43
Pensions	43
Allowances	43
Family Payments	45
Special Benefit	45
Rent Assistance	46
3. Current means testing arrangements	47
Pensions	47
Allowances	48
Special Benefit	49
Family Payments	49
4. Expenditure projections	51
References	53

PREFACE

This paper was prepared for the International Social Security Association Regional Meeting for Asia and the Pacific on 'Financing of Social Security', held in Beijing, China on 18-20 July 1995.

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1. INTRODUCTION

Australia's experience in financing social security payments provides an interesting comparison with the social insurance model generally prevailing in other OECD countries. This paper argues that, as a primarily general revenue financed system, Australia's social security system has been better able to cope with some of the challenges facing many other OECD countries particularly in recent times.

The paper is structured as follows:

- 1: *Introduction*.
- 2: *The Australian Social Security System* briefly describes the main characteristics of the Australian social security system.
- 3: *Historical Overview* deals with the historical development of Australia's public income support system as a general revenue financed system and considers why various attempts to shift to a social insurance approach have been rejected.
- 4: *Contributory and General Revenue Financing - A Comparison* considers the advantages and disadvantages of general revenue compared with social insurance (contributory) financed systems.
- 5: *Recent Developments* examines recent developments in the Australian public income support system in response to demographic, economic and social pressures.
- 6: *Future Directions and Challenges*: Australia examines the direction Australia is taking in response to anticipated future challenges.
- 7: *Summary and Conclusions -Lessons To Be Drawn from the Australian Experience* summarises the paper and considers how the Australian experience with general revenue financing may inform the policy choices facing countries with less developed social security systems or those in transition from a managed to a more market oriented economy.

The paper concentrates on the public income support system. However, much of the argument over the merits of general revenue funded as opposed to social insurance approaches to pension provision revolves around the nature of the various pillars of income support and attention is also given to the private occupational superannuation pillar.¹

1 'Occupational superannuation' is the term generally used in Australia to describe occupational pensions and refers to arrangements for saving towards the retirement benefits of employees.

The link between the social security and personal income tax systems is examined in the paper in relation to specific aspects of financing and also in some detail in Appendix 1.

While the paper deals primarily with pensions (of which pensions for the aged are by far the largest component), it also discusses social security payments for shortterm contingencies and, to a lesser extent, family payments. There is a greater consistency between pensions and other payments in the Australian social security system - for example, unlike in countries with social insurance systems, sole parents in Australia are paid a Sole Parent Pension under similar conditions to pensions for the aged and people with disabilities, and rates of payment to the unemployed are broadly the same as those for pensioners.

The systems in other OECD countries have been the main reference points when making comparisons with the Australian social security system as in both cases the public systems are at a relatively advanced stage of development. While the social insurance model is typical in the OECD countries and well known, there has been a growing appreciation in recent years among these countries of the merits of greater general revenue financing of social security.

2. THE AUSTRALIAN SOCIAL SECURITY SYSTEM

The federal public income support system is the cornerstone of the Australian system of social protection. Payments are financed entirely from the Federal Government's general revenue. State/Territory Governments are responsible for workers' compensation and road accident coverage (which are financed by employers and motorists respectively).² General revenue is also the predominant means of health care funding, although part of the cost is borne by a special income tax levy. Individual patients (except those receiving income support or on low incomes) also contribute to the costs of services they receive. Private occupational superannuation, providing benefits based on employer and/or employee contributions, is a rapidly growing element of provisions for the retired.

In more detail, the main elements of social protection are:

- *the income support system provided by the Federal Government.* This provides flat-rate, means-tested payments to those not expected to work (the retired, sole parents and carers), those unable to work (the sick or disabled) or unable to find work. Most payments are taxable (although rebates ensure that those receiving maximum rates of income support do not in fact pay tax) and additional payments are made to those who pay rent in the private rental market and to those with dependent children;
- *a mix of compulsory and Voluntary occupational superannuation,* which, on retirement, provides either lump sum benefits or earnings-related pensions, or a mix of both. (Further details are provided in Section 5.);
- *compensation arrangements for work injuries and deaths,* legislated by State/Territory Governments and providing for 'no-fault' earnings-related benefits (either as periodic payments or lump sums). These are financed by compulsory, risk-related premiums or levies paid by employers to commercial insurers or, in some States, governmental statewide compensation funds;
- *compensation arrangements for road accident injuries and deaths,* which mainly provide for lump sum damages awards for loss of earnings capacity, medical costs, pain and suffering and defined lump sum amounts for specific injuries. These are financed by compulsory flat-rate levies on motor vehicle owners, again paid to commercial insurers;
- *life and contingency insurance,* which operates through commercial insurers and is essentially voluntary in nature, although supported in some instances by tax concessions;

³ Australia is a federation of States and Territories. The national or Federal Government shares responsibility with individual States and Territories in a number of areas, notably health, education and transport.

- *paid sick leave*, which is provided and financed by employers. Usually this provides full or part income replacement to sick employees for defined periods, generally with arrangements whereby sick leave credits accumulate with increasing length of service with an employer;
- *the health care system*, which is financed partly through a special tax levy (the Medicare Levy), partly from the Federal Government's general revenue, partly by State Governments and partly by contributions from patients;
- *pensions for war veterans and their dependants*, which encompass both income support and compensation elements and are funded by the Federal Government entirely from general revenue; and
- *other cash and in-kind welfare benefits*, such as subsidised public housing and transport, rebates on local government property taxes for pensioners and reductions in charges for utilities such as water, electricity and gas. These are provided by government bodies at national, State and local levels, with the Federal Government providing additional funds to other levels of government in part as compensation for their loss of revenue from providing these subsidies.

In addition, rebates are available within the personal income tax system for sole parents and for spouses with minimal income (although where there are children the assistance is usually paid through the social security system). These rebates are equivalent to cash assistance.

The income support system

The main payments made by the Federal Government are detailed in Appendix 2, together with details of eligibility criteria. The income support system is categorical in its approach to eligibility, although the coverage provided by the system as a whole is so broad as to approach a guaranteed minimum income scheme (albeit with requirements to seek work for some categories). Estimated expenditure on social security and welfare amounts to 36.6 per cent of Federal Budget outlays and 9.2 per cent of Gross Domestic Product (GDP) in 1995-96. Of the total social security and welfare bill, expenditure on payments for the aged is expected to account for 29.2 per cent, payments to war veterans 9.7 per cent, payments to people with disabilities 12.3 per cent, payments to families with children (including sole parents) 27.9 per cent and payments to the unemployed and sick 12.2 per cent (Budget Statements 1995-96).

All the main social security payments are means-tested. The means testing for payments to those considered to be in the workforce is more restrictive than for those not required or expected to work (i.e. pensioners). Details of current means testing arrangements are given in Appendix 3.

4 HISTORICAL OVERVIEW³

Introduction

This section traces the early history of the Australian public income support system and its development, during the first half of this century, into a comprehensive, general revenue funded system of income support. It examines, in particular, the ongoing debate on the financing of the social security system and the various proposals and attempts to change to a system of contributory social insurance. The debate on social insurance subsided significantly only in the 1980s, with social insurance-based financing no longer being supported by either of Australia's major political parties.

1900-1910: The first steps - age and invalid pensions

Australia came into being as a nation in January 1901 when the six formerly separate Australian colonies combined in a federation of six States to form the Commonwealth of Australia. The Australian social security system actually had its origins in the year before federation with the introduction in 1900 of noncontributory, general revenue financed, means-tested age pension schemes in the two most populous Australian colonies, New South Wales and Victoria. These schemes were introduced in response to unfavourable economic and social trends emerging at the end of the 19th century, such as declining rates of economic growth, rising unemployment, increasing numbers of older people and the increasing incapacity of existing charitable and government-run relief schemes to provide adequate assistance to poorer people. Although consideration had been given to financing these early pension schemes along social insurance lines (similar to those then being developed in Europe), such an approach was rejected because of concerns about the administrative costs and difficulties involved in establishing and operating social insurance schemes and about the lack of coverage they would provide for those unable to contribute.

The Australian Constitution, introduced at the time of federation, gave the new Federal Government the power to legislate in regard to age and invalid pensions. The Federal Government subsequently established a national pension scheme in 1908 under which it began paying Age Pensions in 1909 and Invalid Pensions in 1910. These national pensions, like the State pension schemes (then operating in the States of New South Wales, Victoria and Queensland) which they superseded, were also non-contributory, general revenue financed and means-tested. The financing of the national pensions along social insurance lines had been considered by a Royal Commission of Inquiry in 1905-6 but rejected on the basis that conditions in Australia and Germany (whose social insurance scheme was the major model considered by the Royal Commission) were too widely divergent for such a scheme to be practicable in Australia. The Constitutional restrictions on Federal revenue

3 The main source used for historical information on the Australian social security system was Kewley (1973).

raising powers at that time would also have made the establishment of such a scheme problematic.

It can thus be seen that Australia established national pension schemes at a very early stage and from the outset they were general revenue financed.

The social insurance debates of the 1920s and '30s

Debate on methods of financing social security did not stop with the introduction of the general revenue funded national pension scheme. Proposals to introduce a national contributory social insurance scheme were put forward on a number of occasions over the next few decades, most prominently in 1928 and 1938. These arose in response to factors such as the falling living standards of the aged, a desire to reduce public expenditure on the existing national pension scheme and, in the case of the 1938 proposal, a desire to abolish the pension means test. Additionally, in the 1930s the hardships endured by the large numbers of unemployed people during the Great Depression and the difficulties faced by State Governments in providing systems of support for them made clear the need for an expansion of social security on a national level to provide protection for the unemployed.⁴

During this period, the major political parties represented in the Federal Parliament expressed varying degrees of enthusiasm for the concept of social insurance, with debate focusing on such issues as the means of financing a social insurance scheme and on who would be eligible to receive benefits. The conservative political parties favoured a contributory social insurance approach on the grounds that providing a benefit without any obligation on the part of the recipient to contribute to its cost would undermine thrift and self-respect. The Australian Labor Party and the broader labour movement, on the other hand, favoured financing of benefits from consolidated revenue, based on the principle of 'redistribution' rather than 'contribution'. They contended that the cost of social insurance contributions would place an unfair burden on working people and that the costs of support for such contingencies as unemployment, widowhood and old age should be shared by the whole community.

In 1928, based on the recommendations of a Royal Commission appointed in 1923, the (conservative) Nationalist Party Government put forward a National Insurance Bill to introduce a comprehensive social insurance scheme (with the notable exclusion of unemployment insurance), but this was dropped when the Government lost office at the 1929 Federal election. In 1938, although the Federal Parliament actually passed legislation to introduce such a scheme (again excluding unemployment insurance), the legislation lapsed in 1939 just prior to the outbreak of World War II when defence spending became a more urgent priority.

4 The Depression also necessitated the raising by State Governments of considerable amounts of revenue to provide relief for unemployed people. This was done by a major expansion of the income tax system which brought people on lower incomes within the income tax net for the first time.

Although the lost election and the impending outbreak of war provided the main reasons for not proceeding with the introduction of a social insurance scheme on these two occasions, there was also significant opposition to the proposals from a number of groups. Friendly societies (which operated a form of 'voluntary social insurance' for their member contributors) were opposed because they saw social insurance as a threat to their survival. There was concern about the costs of a contributory scheme for employers and (in the case of the scheme proposed in 1938) concern at the exclusion of the self-employed.

As the then Opposition party in the Federal Parliament, the Labor Party in 1938 put forward an alternative proposal which aimed at establishing a unified social security fund derived from consolidated revenue, with benefits covering a broad range of contingencies to be funded from a progressive taxation system. This proposal formed the basis of social security reforms implemented by the Federal Labor Government in the 1940s.

The 1940s: Completing the picture - assistance for families, widows, the unemployed and the sick

In 1941 a new Department of Social Services (renamed Department of Social Security in 1972) was established to administer the social security system.

Previously this had been the responsibility of the Department of the Treasury.

Also in 1941, a Joint Parliamentary Committee on Social Security was appointed 'to report on ways and means of improving social and living conditions in Australia and of rectifying any anomalies in existing legislation'. This committee made broad-ranging recommendations including on the introduction of widows pensions and unemployment benefits.

As part of increasing its powers to coordinate Australia's war effort more effectively, the Federal (Labor Party) Government in 1942 took sole responsibility for income tax which had formerly been partly the preserve of the State Governments. Income tax rates were increased and tax levied on a broader range of income.

These increased powers and revenues provided the opportunity for the Federal Government to greatly enhance its role in social security and to complete the establishment of a comprehensive system of social security which, in the Government's view, would facilitate post-war reconstruction and complement the Government's aim of a post-war economy based on the goal of full employment.

The more important of the new social security payments introduced during the war years, which included those recommended by the Parliamentary Committee in 1941, were Child Endowment ('family allowance') in 1941, Widows Pensions in 1942, funeral benefits for pensioners in 1943 and Unemployment and Sickness Benefits in 1945.⁵ Consistent with the existing elements of the social security system, and as

5 The new unemployment benefit superseded an unemployment insurance scheme introduced in Queensland in 1923 (the only contributory social insurance scheme ever to be introduced in Australia), but which had proved to be generally ineffectual in the face of the massive rise in unemployment during the Great Depression.

foreshadowed in the Labor Party's 1938 proposals for social security, all of these new payments were non-contributory, funded from general revenue and (with the exception of the universal child endowment) means tested.

Along with these new payments, also introduced at this time were new arrangements for administering the financing of social security. In 1945, the Government split personal income tax into two components, one of which, the 'social services contribution', was to be used exclusively to finance social security payments. Revenues from the social services contribution (along with additional subventions from consolidated revenue) were paid into a newly established 'National Welfare Fund' from which all social security payments were to be made. There was, however, no link (intended or actual) between individuals' contributions paid into the Fund and any subsequent entitlements they might have to a social security payment. In other words, the National Welfare Fund and the social services contribution did not, in any way, constitute a move towards funding social security in Australia along social insurance lines.

Following a change of government in 1949, the social services contribution and personal income tax were merged into a single tax levy in 1950. The National Welfare Fund continued to be used as the vehicle through which social security funding was channelled - via transfers from consolidated revenue and income derived from payroll tax sufficient to meet the cost of all social security payments but its role was limited to that of an accounting device. Legislation formally disbanding it was passed by the Federal Parliament in 1985.

The social insurance debate continues: 1950s-1970s

While promising early in the 1950s to investigate again the possibility of financing Australia's social security system along social insurance lines, by the mid-1950s the Government had shelved such plans because a contributory social insurance scheme would have conflicted with its aim of lowering income tax rates.

During the 1960s and early 1970s, various social insurance proposals (including by Professor Ronald Gates in 1965, Professor Richard Downing in 1968 and Bill Hayden MP in 1971 - were put forward but not taken up by the Government. In 1973 the new Labor Government established a National Superannuation Inquiry which was instructed to make recommendations on a 'national superannuation' scheme having regard to the new Government's objective of abolishing the means test on Age Pensions and increasing pension payment rates.⁶

In its final report in 1976 to a newly elected non-Labor Coalition Government, a majority of the Inquiry Committee recommended some departure from general revenue financing and means testing of Age Pensions in favour of a combination of

6 In Australia, the term 'national superannuation' has generally been used to describe a national retirement pension scheme, based at least partly on compulsory contributions and which pays pensions comprising both universal and earnings-related components.

universal and contributory, earnings-related pensions. In summary, the rationale for this recommendation was that:

- a contributory scheme would increase the revenue raising capacity of the Government and allow it to increase the overall level of income support available to the aged;
- the private occupational superannuation system had proven to be inefficient in providing retirement incomes for low and middle income earners; and
- avoidance of a means test on age pensions was worthwhile because this would enhance the dignity of pension recipients (with eligibility being based only on status as an elderly citizen, not on proof of poverty) and because means tests were apt to be resented as penalties against industry and thrift.

The scheme recommended in the majority report of the Inquiry incorporated a compulsory contribution of 5 per cent of income above an exempt amount. Benefits would comprise a universal pension largely financed from general revenue, an additional earnings-related pension linked to contributions, and supplementary pensions for people whose additional pension was insufficient to provide them with a specified minimum level of retirement income. Although individual records of contributions were to be kept, contributions were to be paid into general revenue and the scheme was to be financed on a 'pay-as-you-go' basis.

As the Inquiry believed that a higher priority should be given to increasing the general level of pensions rather than providing large pensions to people with high pre-retirement incomes, the recommended scheme had a significant redistributive element. While the contributions were generally intended to finance the earnings-related pensions of individuals, some proportion was also to be used initially to finance the universal pension and supplementary pensions. It was considered that, given that contributions to the scheme were to be compulsory, some degree of earnings-related benefits was required if the contributions were not simply to be seen as an increase in income tax.

A minority report of the Inquiry, by contrast, argued that the compulsory and redistributive aspects of the recommended scheme would mean that people would generally regard their contributions as taxes. It contended that the Inquiry's objectives could be equally met by making changes to the existing pension system: by paying universal age pensions and by making improvements to the structure and operation of voluntary occupational superannuation. Such an approach would also preserve individuals' freedom of choice as to whether and how they wished to supplement their age pension.

Following lengthy consideration, the scheme recommended by the majority of the Committee was rejected by the Coalition Government in 1979 for the following reasons:

- despite the linking of contributions to earnings-related benefits, such contributions would tend to be viewed as an additional income tax. The levying

of contributions would have run counter to the Government's general objective of reducing tax on individuals and, in particular, would have added to the tax burden on middle and lower income families;

- the increased levels of assistance to the aged recommended by the Inquiry would have broken the existing parity between age pension payment rates and rates of other social security payments and impeded the Government's ability to meet other social welfare priorities;
- the compulsory nature of the scheme was contrary to the Government's view that individuals should be free to choose the form in which they saved to provide a retirement income; and
- the provision of universal benefits to all aged people did not accord with the Government's view that social security assistance should be directed to those most in need.

Social insurance rejected: The 1980s

Following the election of a Federal Labor Government in 1983, the Senate Standing Committee on Social Welfare began an inquiry into retirement income systems. Although giving consideration to the introduction of a national superannuation scheme, the Committee rejected this approach in favour of encouraging the growth of private occupational superannuation and better integration of private pensions with the social security Age Pension.

In 1985, the Government established the Social Security Review to examine and make recommendations for reform of all major aspects of Australia's social security system. When considering reform of the retirement income system, the Review concluded in 1988 that the opportunity for introducing a national superannuation scheme in Australia had passed. It considered that the problems of fiscal inflexibility and future costs associated with a maturing, unfunded social insurance based age pension scheme in the context of an ageing population could not be justified.

The Review argued that an earnings-related contributory retirement pension would split the Australian social security system into a social insurance scheme for the aged and social assistance for all other categories of recipients, which could have the effect of undermining the legitimacy and adequacy of payments for the latter. The Review therefore considered it crucial that the existing Age Pension retain its central role in a general revenue funded social security system, with the goal of more adequate retirement incomes being achieved through a combination of social security pensions paid at higher rates to better assist those with the lowest incomes and significantly expanded occupational superannuation coverage of those in the workforce. The introduction of a social insurance system has not been in the platform of any political party since then.

Means tests on pensions: An enduring feature of the Australian social security system

Means tests became firmly entrenched in Australia's social security system during the course of its early development in the first half of this century. Means tests were applied to almost all payments introduced during this period with the emphasis, in a non-contributory, general revenue funded system of social security, on targeting payments to those most in need. Few changes were made to means testing arrangements from the time they were introduced until the 1960s, but any changes were almost entirely in the direction of liberalisation and increased access. More significant steps were taken in the expansionary years of the early 1970s with the abolition of the means test for some age pensioners - moves which were later reversed in the context of tighter targeting of payments and expenditure restraint.

Before 1961, the pension means test comprised separate tests on income and property. A 'merged means test' was introduced in 1961 under which, for each complete \$A20 that the value of the pensioner's property exceeded a specified limit, \$A2 was added to the pensioner's annual income. Any income above the specified annual limit (known as the 'free area') reduced the pension on a dollar for dollar basis. In 1969, a 'tapered' means test was introduced by which the pension was then withdrawn at the rate of 50 cents for each dollar of income above the free area.⁷

In the early 1970s, there was general support across political parties for at least partial abolition of the means test on Age Pensions. In 1972, free areas were doubled by the Coalition Government and a commitment made to abolish the means test for those aged 65 and over. In 1973, the newly elected Labor Government abolished the means test for pensioners aged 75 and over and, in 1975, for those aged 70 to 74.

The vastly changed economic conditions emerging in the mid-1970s stopped any further abolition moves although, in 1976, the Government liberalised the means test by replacing the '\$A2 for \$A20' property rule with actual income from property in the definition of income. The means test then became a test on income alone. This move followed the recommendation of the 1975 report of the Commission of Inquiry into Poverty which argued that pensioners should not have to run down their assets to make themselves eligible for the pension.

In 1978, as part of the Government's efforts to contain the growing Federal budget deficit, the rates of the income test free pension for pensioners over 70 were frozen (that is, these pensions were no longer subject to regular indexation, although the pensioners affected could apply for the normal indexed and income-tested pension) and, in 1983, the over-70s' frozen pension was again made subject to the income test. In 1985, a separate test on assets was added to the income test, thereby returning the means test to its more traditional role of determining pension eligibility on a test of both income and assets.

⁷ Free areas at that time were relatively generous, equating to around 67 per cent of the pension rate for single pensioners compared to around 28 per cent currently.

There have been a number of changes to the pensions means test since 1985. These have mainly been designed to adjust the definition of assessable income. A major initiative was to introduce the concept of 'deeming' a minimum income on certain assets, to counter the practice where people sought to minimise income to maximise pension entitlement. Deeming on bank deposits was first introduced in 1990 and will be further extended in July 1996. The basic structure of the test has, however, remained unchanged. The details of current means testing arrangements are outlined in Appendix 3.

4. CONTRIBUTORY AND GENERAL REVENUE FINANCING -A COMPARISON

Asian and Pacific countries contemplating the future of their social security systems will generally be familiar with the social insurance model existing in the majority of OECD countries and the general revenue method of financing used in Australia and New Zealand. A comparison of the impact of the two methods of financing on individuals and the economy follows.

The discussion also involves an assessment of the relative merits of 'universal' vis-à-vis 'selective' social security systems. This reflects the fact that the method of financing and the benefit structure are closely related. The relationship exists because earnings-related benefits paid without a test on income or assets are a general feature of contributory systems but are incompatible with a general revenue financed approach, while a general revenue financed system is more likely to provide flat-rate benefits which may also be means-tested.

Limitations of the comparison

The comparison in this paper is restricted mainly to public income support systems. While these systems are the main instrument of social protection in all OECD countries, the limitations inherent in the comparison need to be considered.

The systems will be compared in terms of their impact on such variables as poverty, income distribution and work incentives. But countries seek to achieve objectives in these areas not only through public income support but also via a range of health and welfare services, private income support, taxation policies and sometimes wages policies (some or all of which may not be solely or primarily the responsibility of the central government). Furthermore, it is not only the method of financing which is important in achieving objectives but also the quantity, quality and type of assistance.

Another difficulty is that the objectives of different countries' social security systems may vary. For example, in a retirement income system the two principal objectives are: to provide a level of income that meets at least a minimum standard (the poverty alleviation objective) and to maintain to an acceptable degree a person's preretirement standard of living (the income maintenance objective). The Australian pensions system for the aged has poverty alleviation as its main objective while social insurance systems tend to give more emphasis to the income maintenance objective. Any assessment of the two systems will depend in part on the relative emphasis put on one or the other objective.

The issue is complicated further in that certain objectives may be achieved by different systems and combinations of systems. For example, income maintenance is a major objective of countries with social insurance systems but in Australia this objective is largely left to the tax subsidised occupational superannuation pillar of the retirement income system. The debate about the best way of financing the public

pillar therefore may not always be the crucial question but rather what, for stated objectives, is the appropriate structure for a retirement incomes system.

Features of social insurance (contributory) systems

In general terms the 'typical' social insurance system in OECD countries has the following features: it is financed from compulsory contributions levied on employers and/or employees in the form of payroll taxes and it pays 'defined' earnings-related benefits on a pay-as-you-go (PAYG) basis. Because schemes with these characteristics predominate, the comparison here is essentially between such schemes and ones financed by general revenue. It is recognised that, in reality, individual countries to varying degrees deviate from this paradigm - for example, a number of OECD countries (particularly the UK) have significant elements of general revenue financing.

In particular it should be noted that the PAYG method of financing is not inherent to contributory financing - in fact the use of full funding in keeping with the private insurance analogy is sometimes put forward when the theoretical merits of this method of financing are discussed. However, in practice PAYG financing is by far the principal method which has been adopted in social insurance systems in the OECD countries and there is ample experience on which to evaluate it. Accordingly, while reference is made to the funded alternative, the main focus of the present comparison is between contributory schemes financed on a PAYG basis and general revenue financing.

The establishment of fully (or partially) funded schemes has generally been seen as the solution to the problems of PAYG schemes (see, for example, recommendations for European Community countries in CEPS, 1993). There has been little examination of the general revenue alternative as (notwithstanding emergency subventions) this is not a customary way of financing pensions in OECD countries. It is intended that the present report will provide some food for thought on the possibilities of general revenue financing.

Problems experienced by social insurance systems

Much has been written about the problems OECD countries have experienced in recent years in financing social security, particularly pensions.⁸ Early in their life PAYG schemes appear attractive as contributions typically exceed benefit outlays. short-term surpluses can breed a false confidence when long-term pension liabilities are not clearly apparent. There has been a tendency for overly generous provisions to be built into the initial schemes. The provision of 'defined' benefits means that there is no necessary relation between contributions and benefit promises. The maturing of the schemes, unfavourable external conditions such as ageing populations and slower economic growth, and the tendency to increase coverage of new groups can result in benefit outlays exceeding contributions received by significant amounts in later years.

8 See, for example, OECD 1988, OECD 1989, OECD 1993, Hoskins 1992, CEPS 1993, DSS (UK) 1993 and World Bank 1994.

Governments have sometimes reacted to these cost pressures by raising contribution rates, reducing benefit levels and increasing eligibility ages. Non-indexation (or less than full indexation) of benefits has also been used as a means of reducing government outlays on pensions. However, the most common response has been to prop up the schemes by meeting deficits with substantial subventions from general revenue, even though this may be financially unsustainable in the longer term. Governments clearly face political difficulties in reducing benefits/tightening eligibility given the semi-contractual nature of the schemes and the expectations that have been built into them.

Comparing the systems: Main criteria

The comparison between general revenue and contributory financing of public income support which follows compares the methods of financing on the basis of a range of criteria.

Poverty alleviation

The Australian system of general revenue financed flat-rate benefits is likely to produce greater 'target efficiency' than the social insurance approach with its earnings-related benefits. This is because, for a given level of expenditure, it is possible to have a greater impact on poverty if flat rates of benefit are paid than if benefits are earnings-related. If benefits are also means-tested the level of minimum payment provided will be even greater.

It is difficult in a social insurance system to provide assistance to those who have little or no capacity to make contributions. For those who are covered, the extent to which poverty alleviation is possible is inhibited by the provision of earnings-related benefits. As the OECD observes (1988, p. 93), 'In public pension schemes the insurance function and the redistributive function are in inherent conflict, manifest in the concerns for individual equity and social adequacy that are always present to some degree.' The more 'vertical redistribution' within the earnings relation (and some countries' schemes incorporate a considerable degree of this), the greater is the contribution to the poverty alleviation objective. But the more this objective is achieved, the more spurious becomes the insurance analogy so that instead of being a price for insurance, it is difficult to argue that payroll tax contributions are other than a pure tax.

A high level of 'target efficiency' is not of itself evidence of effectiveness in reducing poverty if rates of payment are very low (or if means tests lead to low take-up). However, the higher minimum benefit possible for a given level of expenditure under a flat rate system financed from general revenue is an important potential contributor to poverty alleviation. Advocates of social insurance sometimes suggest that this is compensated for by the greater capacity of the insurance alternative to generate higher taxes and these taxes can then be used to alleviate poverty. It is interesting to note that an international comparison of minimum benefit levels (paid under a variety of arrangements such as social insurance, non-contributory pensions and social assistance) available to single older people, adjusted for purchasing power parities, ranked Australia fifth highest among 20 mainly OECD countries in 1991 (Whiteford 1995).

Income distribution ⁹

Because defined benefit schemes by their nature do not contain a precise actuarial relationship between contributions and benefits, there is inevitably an intra-generational redistributive effect. Despite progressive features in PAYG schemes such as minimum and maximum levels of benefit, the range of studies on intra-generational transfers (World Bank, 1994, p. 131) show little, if any, redistribution from the 'rich' to the 'poor' within a generation. These studies have also highlighted unintended redistributions such as from two to one wage-earner families and from women working in the labour market to those who stay at home. The only indirect evidence available suggests that in developing countries' schemes intra-generational redistribution has been even less progressive.

Inter-generational transfers on the other hand are an inherent feature of PAYG schemes because of the 'windfall gain' to earlier generations at the expense of later generations. The less favourable external factors in recent decades (particularly the demographic factor) and the early policy choices have aggravated this. Empirical evidence to date (World Bank, 1994, p. 132) shows consistently that a significant redistribution to earlier generations at the expense of later generations has already occurred and that this will become stronger if major changes to PAYG schemes are not made. This has been unintentional and has not been progressive - in every case earlier generations have fared better than later generations regardless of income.¹⁰

Under the Australian system of general revenue financing, all payments are made to current pensioners and other social security recipients from taxes paid by the current population. Any distribution within the current generation is relatively transparent and tends to be that which the government deems appropriate at the time. Unintended inter-generational redistributions are also less likely to arise. The redistributive impact under general revenue financing is likely to be much more short-term and transparent than under a social insurance system financed on a PAYG basis. Furthermore, while there is undoubtedly some perception in Australia that pensions are an entitlement in return for taxes paid, it is unlikely to be as strong as under a social insurance scheme. The semi-contractual relationship which exists between the government and pensioners under the latter tends to foster the illusion, no matter how far from actuarial reality a scheme may be, that pensioners have fully paid for their present entitlement. It is therefore easier to make changes involving reductions in rates and or conditions of pensions under general revenue financing.

Treatment of disadvantaged groups

Under social insurance some people do not have any entitlement to a benefit. These comprise persons with no previous attachment to the labour force, whose attachment has been insufficient to build an entitlement or, in the case of short-term benefits, whose entitlement has run out. At the same time among persons qualifying for a

9 The main sources for this section are World Bank 1994, pp. 11, 88-90, 130-135, 235-237; OECD 1988, pp. 94-96; and OECD 1989, pp. 18-19.

10 The World Bank report (p. 11 and pp. 131-133) outlines six reasons for this lack of progressivity within and/or between generations, which include the fact that the 'rich' on average live longer than the 'poor'.

benefit, those with the lowest earnings histories and/or the shortest qualifying periods of employment receive the least.

People who tend to miss out entirely on social insurance payments include groups such as those disabled from birth and the long-term unemployed. Persistent high levels of unemployment in recent years and social factors such as the spread of more diverse working patterns have increased the potential for people to fall through the 'cracks' in the social insurance system.

Those who receive the lowest benefits, although covered, are typically sole parents (other than widows benefiting from contributions made by their husband before his death), women generally (because of their lesser formal labour force attachment than men) and groups such as recently arrived migrants. To the extent that there is redistribution to those on lower incomes within the insurance system, the position of special groups within the qualifying category is better but this cannot go too far without straining the link between contributions and benefits.

OECD countries invariably have special provisions outside the social insurance system to cover disadvantaged groups. These generally involve social assistance (although, particularly for the aged, there may be more generous provision). Social assistance is generally paid at a low rate and rigorously means tested, and is often administered at the local government level with extensive discretion. These features, plus the exclusion of the group from the social insurance system, can be stigmatising. However, it is difficult to provide more generous assistance as, if assistance approaches too closely earnings under the insurance system, contributors may start having doubts about the value of the return from their contributions.

Under Australia's general revenue financed system, payments are made on the basis of need and are the same for all persons in the same circumstances at a given point of time. Coverage of those with limited means is very broad (essentially only persons who are not permanent residents miss out).¹¹ Higher payments are made for married couples than for single people (thus the system avoids such complex issues as the appropriate social security treatment of married women who have been in the labour force vis-à-vis other married women who rely on their husband's contributions). Major supplements are provided where there are dependent children and for renters in the private market.

It is critical to recognise that the Australian system is more than a vast social assistance system. Means tests (especially for pensions) allow a recipient to have significant income and assets so that, for example, some 76 per cent of the aged are in receipt of an age or equivalent pension. Entitlements are clearly defined in legislation and subject to administrative and then judicial appeal. The means test is not regarded as particularly intrusive while stigma and low take-up, often alleged to be features of means-tested systems, have not been significant problems.¹² Overall

11 Special Benefit is available within the Australian social security system for certain legal residents in hardship not entitled to other social security payments. It is analogous to social assistance within a system where mainstream payments are financed from general revenue.

12 Garfinkel (1982, pp. 496-497) notes inter alia that a program covering most of the population will tend not to be stigmatising.

the system effectively provides a guaranteed minimum income for people in a wide range of categories.

Earnings replacement

The main objective of Australia's general revenue financed public income support system is poverty alleviation. Nevertheless the provision of flat-rate payments does not necessarily imply low earnings replacement rates. For families with low earnings, replacement rates may be quite high, especially as higher payments are made to married couples, for those with dependent children and for renters in the private market. A number of non-cash 'fringe benefits' (such as concessions on the price of pharmaceuticals for pensioners) are also available. Accordingly, low income earners may sometimes fare better than similar groups under some social insurance systems. The objective of higher replacement rates for higher income earners in Australia is left to tax subsidised private occupational superannuation, special forms of insurance (such as for industrial injuries and road accidents) and to voluntary saving.

*Savings and investment*¹³

The issue of whether public pensions schemes have an impact on savings and investment has for many years been a subject of intense academic debate. In 1974, Feldstein reported results of a study which indicated that the US public pension scheme had led to a considerable reduction in private saving, capital accumulation and growth. Feldstein's calculations were subsequently considered to be flawed and later empirical studies, while perhaps indicating on average some slight negative effect, have had ambiguous results. Overall the OECD (1988, p. 61) reports that 'The diverse theoretical arguments advanced in these papers and the differing empirical results must lead to the conclusion that the case for public retirement provisions having substantially reduced aggregate savings and consequently the rate of growth is not strong'.

Notwithstanding this finding, there appears to be a general consensus that private pension schemes do lead to some increase in saving (Butare 1994, p. 27) and that moving from unfunded public schemes to fully funded private schemes (if the latter are appropriately managed) would improve savings and investment (OECD 1988, p. 63 and World Bank 1994, p. 93).

Two factors have conflicting effects in the Australian system. On the one hand, for middle and high earners the low earnings replacement rate, together with tax concessions, provides a strong incentive to participate in occupational superannuation and life assurance (apart from for employees in the public sector, occupational superannuation schemes are generally funded). This incentive has been less relevant since 1992 when private superannuation contributions became compulsory. On the other hand the pension means test on assets and income may discourage saving by some or at least encourage spending of superannuation lump

13 The sources for this section are OECD 1988 (pp. 61-63), OECD 1989 (p. 13), World Bank 1994 (pp. 93, 158, 275 and 307-310) and Butare 1994.

sums (these are very popular because of their concessional tax treatment). No conclusive evidence is available on the net effect of the above factors.

It is not possible from the evidence available to conclude that general revenue financing would have a more or less positive impact on saving and investment than a social insurance scheme financed on a contributory basis.

Incentives to work and pay taxes

Payroll taxes levied on employers and/or employees to finance social security (mainly for pensions) are very high in many OECD countries (and even higher in the former Soviet bloc countries of Central Asia and Central and Eastern Europe). Much is made in the literature of the supposed adverse effects of such taxes on incentives for enterprises to take on workers or on employees to work. The relevant issue here is how this varies due to the method of financing used and whether general revenue financing would create more or less distortions in the labour market.

The OECD (1988, p. 96) has examined the empirical evidence of the impact on the labour market of altering the revenue structure. It found that simulations using econometric models have produced variable results but in most cases the apparent impact on employment has been small. Overall (and supported by its own work) it states: 'The general conclusion which can be drawn from these studies - namely, that pure shifts in the general revenue structure are unlikely to create substantial employment effects, especially in the long run - matches the view held by most economists'.

Work disincentives are often linked to high effective marginal tax rates although there is debate about the actual extent of their impact. Personal income tax systems generally provide exemptions for low income and dependants, and other concessions. The revenue foregone through these concessions is generally made up by requiring higher marginal tax rates at higher levels of income. By contrast, payroll taxes are usually broadly proportional to income. Accordingly, while less progressive, in this aspect payroll taxes may have less adverse work incentive effects than the personal income tax. On the other hand there is no reason why a less progressive income tax could not be designed provided that the distributional consequences were considered acceptable while the visibility of the payroll tax's link to employment may be a factor in reducing work incentives. Ultimately what is important for incentives is the total tax mix. In any event there has been little evidence of significant behavioural effects arising from high effective marginal tax rates in Australia and theoretical analysis, just as the empirical evidence, does not enable a conclusion to be drawn on the relative merits of the two methods of financing on work incentives.

A major issue in recent years in countries with high payroll taxes has been tax evasion by enterprises and workers through underreporting of income, moving into the informal economy (or simply open non-compliance in some countries) and tax avoidance through exploitation of legal 'loopholes'. Higher payroll taxes to make up the resulting shortfall only increase the incentive to evade or avoid still further.

Evasion and avoidance tend to be an even greater problem in developing countries where the informal sector of the economy is generally very large and where administrative systems for tax collection tend not to be well established.

In comparing the situation under general revenue financing, it should be noted that incentives to evade and avoid tax may depend on average tax rates as well as on marginal rates. To the extent that universal systems with earnings-related benefits are more likely to be financed by higher tax rates than under a system of general revenue financed flat-rate benefits (particularly if means-tested), the general revenue financed system may have an advantage. On the other hand to the extent that contributions are seen as the price of present family security and future benefits rather than a tax, the incentive to evade/avoid may be reduced. Certainly Australia has not escaped the problem of tax evasion and avoidance but has taken a range of stringent measures to reduce them in recent years.

Fiscal policy

Financing of pensions on a contributory basis has tended to place constraints on fiscal policy flexibility in OECD countries. The short-run surpluses generated at the schemes' inception and the non-transparent nature of the financial impact seem to have led governments to make generous spending decisions in the early years. Later when the schemes have matured the pension funds tend to run deficits which are paid for via subventions from the Treasury. This has led to financial problems in some countries and, given the political difficulties with increasing taxes, limited their capacity to exercise alternative spending choices.

A further problem is that, with earmarked taxes as used under contributory financing, tax rates may be determined by the financing needs of the particular program rather than the overall requirements of fiscal and social policy. This may lead to perverse results such as during an economic recession, when higher contributions may be required to finance the deficit resulting from recession induced losses in revenue in direct conflict with a government's fiscal policy stance.¹⁴

In theory at least fiscal flexibility appears to be a real advantage held by general revenue financed social security systems over those financed by contributions. With general revenue, spending decisions are perhaps more likely to be based on current priorities and economic conditions because governments are less locked in by previous promises which are politically difficult to reverse. The extent to which this flexibility exists in practice is difficult to assess. Governments always have the option of implementing their fiscal policy objectives by making adjustments to nonsocial security taxes and spending. At the same time even under general revenue financing spending commitments may be difficult to reverse.

14 This problem arises particularly with unemployment insurance as contributions to employment funds invariably contract in recessions.

Taxable capacity and public acceptability

Perhaps the major advantage claimed for contributory financing is that it has greater public acceptability than general revenue financing, so that the potential revenue available for spending on social security is substantially higher. Two aspects that need to be considered here are the presumed greater willingness of taxpayers to finance social security spending if it is based on individualised contributions and provides earning related benefits and the greater public support for 'universal' as opposed to 'selective' arrangements. This point is often made to counter the argument that general revenue funded/selective systems are inherently better at poverty alleviation. For example, it is put strongly by Saunders (1994, p. 45), who states that '... the willingness of taxpayers to finance the activities of government, and thus to provide their political support for them, may not be independent of the form that those activities take. Australia's emphasis on social security targeting unlike universalist or contributory social insurance approaches - may well have undermined broad-based support for social security and thus led to a lower level of social security expenditure'.

International comparisons of tax levels and social security spending could be considered to support the taxable capacity argument. Tax levels in Australia (OECD 1994) are the second lowest of 24 OECD countries, being higher only than in Turkey. Total tax revenue in 1992 was 28.5 per cent of Gross Domestic Product (GDP) in Australia compared with an average (including social insurance contributions) of 38.5 per cent in OECD countries generally. At the same time total spending on old age, disability and survivor pensions in 1990 in the average OECD country was 24 per cent of government expenditure and more than 8 per cent of GDP (World Bank 1994, p. 27) compared with 16 per cent and less than 4 per cent respectively in Australia.

A key issue here is to what extent the greater tax revenue gained can be redistributed to the 'poor'. After all, the legitimacy and acceptance of social insurance hinges largely on the extent that contributors will receive (or perceive they will receive) a benefit commensurate with their specific contributions.¹⁵ The discussion on these issues ultimately reflects the problem in attempting to reconcile the conflicting objectives of poverty alleviation and income maintenance in a single public scheme.

A related issue is the extent to which the greater public acceptability of a contributory scheme than a general revenue financed one protects social security from major expenditure cuts by governments. The OECD (1988, p. 94) notes the general feeling in OECD countries that the revenue and benefit structure should be reasonably close as this is likely to constitute a guarantee of continued public backing. On the other hand Hoskins (1992, p. 39) states that in recent years '... means and income-tested benefits have been strikingly vulnerable to reductions, probably because such benefits are, far more than social insurance benefits, dependent upon general political support'.

15 It is frequently suggested that if the employee rather than the employer pays the payroll tax he/she will have a stronger awareness of the link between contributions and benefits.

The Australian experience shows that the social security system, despite severe economic pressures in the last one to two decades, has not only survived but continues to develop in an atmosphere of general acceptance by the community. Social security expenditure has, at the same time, been subject to very close scrutiny by the Government both in terms of current and prospective outlays.

Administrative costs

Social insurance requires complex systems for determining and collecting contributions and for determining and paying benefits on the basis of past contributions. Historical contribution records have to be kept for each insured person. General revenue financing enables significant administrative simplification in this aspect.

The lowest cost scheme administratively is likely to be one paying flat-rate benefits from general revenue. Means tests (as in the Australian system) involve additional administrative costs as information on the income and assets of claimants has to be collected and verified and the level of entitlement calculated. However, in countries such as Australia with a well developed administration and advanced computer systems, the basic means-testing processes are relatively straightforward. Expenditure projections are also relatively simple under general revenue financing (the estimation process in Australia is described in Appendix 4).

Statistics collected by the ILO ('Cost of Social Security' as cited in Mitchell et al 1994, pp. 336-338) show that the average cost of administering social security payments in Australia over the decade 1980-89 as a proportion of total social transfers was 2.4%. This was lower than eight of nine other OECD countries (only Norway with 1.9% was lower) and compared with an average of the ten countries of 3.7 per cent. Australia's costs were considerably less than in countries with a significant earnings-related component in their payments.¹⁶

16 An aspect of universal systems not included here which is more costly than selective systems is the greater 'churning' of payments through both the social security system and tax systems.

5. RECENT DEVELOPMENTS

The changing economic and social environment

Having discussed some of the theoretical advantages and disadvantages of general revenue financing, it is worth examining how the Australian system has coped in practice with the rapidly changing economic and social environment of the last two decades. The pressures on the Australian social security system, which have been similar to those faced by social insurance systems generally in the OECD countries, are as follows.

Ageing population

While Australia is behind most developed countries in the rate at which its population is ageing, this factor is already impacting on social security expenditure and, notwithstanding some offsetting factors, will have a significant impact in the medium term. Substantial immigration in the 1940s, 1950s and 1960s kept the age profile young, but as immigration as a proportion of the already existing population has declined, its impact in ameliorating the ageing of the population has lessened. The proportion of Australians aged 65 and over will almost double between 1990 and 2031, from 11 to over 20 per cent.

Increased unemployment

Australia, in common with many other countries, has experienced a number of economic difficulties since the mid-1970s, with recessions in 1975, 1982-83 and 1990-92. In addition, the economy has entered a period of large-scale structural change, with the agricultural and manufacturing sectors diminishing in importance and technological change in other areas (such as the banking and telecommunications sectors) creating demand for new skills and making other skills redundant. Many of those displaced from employment have been located in regions with limited employment alternatives or have had skills not readily transferable to areas of expanding employment. These factors have led to a substantially increased level of unemployment. Unemployment was negligible at the beginning of the 1970s, but rose to over 11 per cent in the recession of 1990-92 and is currently (May 1995) 8.5 per cent. A feature of the growth has been a major increase in the numbers of long-term unemployed.

Changes in work patterns

There are a number of longer term trends in the structure of the Australian workforce which have and will continue to have implications for the social security system. Women's participation in both full-time and part-time work, while lower than in many OECD countries, is increasing steadily while male participation in full-time employment continues to fall. While most jobs are still full-time and permanent, an increasing proportion are now part-time and/or casual. Self-employment is also increasing.

Diversity in family structures and life patterns

The increasing diversity in the labour market has been accompanied by increasing variation in the way that people organise their lives and life cycles. A substantial rise in the rate of separation and divorce has led to a large rise in the number of sole parents and a declining proportion of couple families following the model of breadwinner father and child caring mother. Once men could be expected to remain in full-time employment for most of the period between leaving school and reaching retirement age and women to withdraw from paid work after marriage or childbearing. For many people, these former patterns and expectations are no longer relevant. Increasing proportions of people are choosing (or forced) to combine or alternate paid work, unpaid caring work, education and training over the course of their lifetimes. A further important change is that people are tending to retire from paid work at younger ages for both voluntary and involuntary reasons.

The policy response

These pressures have led to demands for increased social security coverage of the population together with increases in the levels of payments. Concurrently with these pressures for increased expenditure, Australia's growing foreign debt and balance of payments problems were leading to pressure for reduced public sector spending. In response, following a period of comparatively little change in Australian social security during the 1950s and 1960s, the 1970s saw a number of significant developments and reforms which have continued through the 1980s and 1990s. Responses in Australia, many of which followed recommendations of the Social Security Review, have included:

- increases in coverage/extensions of eligibility;
- increased adequacy of payments;
- reductions in expenditure via specific cuts;
- increased targeting and better fraud control;
- 'Active Society' measures aimed at increasing work opportunities;
- and measures to substantially increase the coverage of occupational superannuation.

Some of the more important specific responses to the changing economic and social environment over the last dozen or so years are detailed below. These changes have been facilitated by the capacity under a general revenue financed system to vary entitlements. This capacity would be less likely to be readily available under a social insurance system with individually defined entitlements related to the length of previous employment and level of earnings.

Increased coverage and extensions to eligibility

Key increases to coverage and extensions to eligibility include:

- a series of reforms, commencing in 1993, which through Additional Family Payment (AFP) has provided significant additional assistance to working families with children with low to moderate incomes;
- the introduction in 1983 of a spouse carer's pension for husbands caring for their severely disabled age or invalid pensioner wives (a wife caring for a disabled husband had long been catered for by the provision of wife's pension). This payment was progressively broadened to cover carers of other relatives, carers of non-relatives, carers not living in the same home, but in neighbouring dwellings and carers of those not eligible for pension because of residency requirements;
- the extension in 1986 of Rent Assistance to recipients of short-term benefits and in 1987 to recipients of Family Allowance Supplement (now AFP), along with the removal of the separate waiting period for Rent Assistance for families on these payments;
- the replacement in 1987 of Handicapped Child's Allowance (which was subject to an income test when paid to less than severely disabled children) with an income test-free Child Disability Allowance;
- the introduction in March 1994 of a Mature Age Allowance for the older longterm unemployed, with no activity (work) testing;
- the introduction in September 1994 of Home Child Care Allowance (which replaced an income tax rebate for couples with dependent children) and its absorption in July 1995 into Parenting Allowance, both payments aiming to give parents outside the paid workforce and caring for children an independent income and a greater choice as to their level of workforce participation; and
- the introduction from February 1996 of a means-tested Maternity Allowance, to assist with the costs incurred by a family at the time of the birth of a child.

Adequacy

A key element in maintaining the adequacy of payments has been their regular indexation to the Consumer Price Index (CPI). Automatic twice yearly indexation of the main income support payment rates to the CPI was introduced in 1976. Indexation has been continuous since then although the frequency was reduced to annually in 1979 but restored to twice yearly in 1980. Annual indexation of all 'family' payments was introduced from January 1990 and of Rent Assistance in 1991. Currently virtually all payments are subject to indexation. In addition, there have been a number of increases to payments above indexation so that the value of basic payments have increased in real terms.

Another important contribution to adequacy has been substantial increases since 1983 in mean-tested family assistance. In 1989 'benchmarks' of adequacy for family payments were established and have since been maintained. These represent specified percentages of the combined married rate of pension (initially 15 per cent in the case of a child under 13 years and 20 per cent for a child aged 13 to 15 but increased to 16.2 and 21.2 per cent respectively in 1992). Substantial real increases in family payment levels were made between 1987, when the package was announced, and 1989 when the benchmarks were reached.

Rent assistance has also been subject to substantial increases in real terms since 1990.

The adequacy of social security payments has not been the only factor affecting the incomes of social security recipients. Others have included increased private incomes, either from savings (particularly in the case of age pensioners, as superannuation coverage has increased) or from earnings (particularly for sole parent and disability support pensioners) and the Child Support Scheme. Among the factors contributing to the increases in earnings have been a number of programs, including the Jobs, Education and Training program for sole parents, the Newstart program for unemployed people and the Disability Reform Package. These programs are discussed in more detail later.

Another objective has been to encourage the maximisation of investment income among pensioners. A Financial Information Service was launched by DSS in 1989 with the aim of encouraging pensioners to maximise their total incomes by ensuring that they had accurate information on the effects of the income and assets tests and the taxation system. In March 1991, 'deeming' provisions were introduced to set a deemed interest rate for cash assets above a set limit, with the aim of encouraging pensioners to increase their incomes by moving cash assets into accounts earning a least the 'deeming' rate. The deeming rate is set according to a formula based on the return from various types of bank deposits.

From July 1996, the deeming arrangements will be extended to cover all financial investments held by pensioners. A deeming rate of 5 per cent will apply to the first \$A30 000 of investments held by single pensioners and the first \$A50 000 of investments held by couples, with a rate of 7 per cent to apply to investments above these amounts. If pensioners' investments earn above the deeming rate, the extra returns will not count as income and will not affect their pension rate.

The Child Support Scheme was introduced in 1988. This aimed to increase the proportion of sole parents receiving child support payments from their former partners and the levels of support. At the same time, the income test arrangements for sole parent pensioners receiving child support payments were liberalised to ensure that pensioners received a benefit from the Scheme.

Expenditure restraint

Given the pressures mentioned earlier, such as rising unemployment, demands for increased adequacy and coverage and ageing of the population, a wide range of measures has been necessary to contain expenditure. These have included restrictions on eligibility, the imposition of (or increases in the stringency of) income and assets tests, tighter fraud control, better debt recovery and more efficient administration.

Restrictions on eligibility have included lowering the maximum age of a qualifying child for sole parent pension to 16, introducing waiting periods and exclusion periods after voluntary resignation for unemployment payments, restricting eligibility for sickness allowance for those who have received compensation payments, tightening the medical requirements for invalid pension (now disability support pension) and tightening activity test requirements (that is, in relation to job search and participation in education or training) for unemployment payments.

Key changes to income and assets testing designed to reduce expenditure have included the removal of the income test-free pension for those aged 70 and over in 1983, the introduction of an assets test on pensions in 1985, imposition on the Family Allowance of an income test in 1988 and an assets test in 1992 (at relatively high levels of income and assets respectively) and substantial changes to the treatment of investment income for pensioners.

Substantial savings in outlays on sole parent pensions have been realised through the Child Support Scheme.

Fraud control measures have included the introduction of mobile review teams (which comprise staff trained to conduct reviews of clients in their homes), the introduction of a requirement that clients provide a tax file number to obtain payment combined with data matching with tax office records, computer matching of Department of Social Security (DSS) records with those of other departments delivering income support payments and with immigration records, and matching of new claimant details against existing records of income support recipients.

'Active Society' measures

The measures described below are based on the 'Active Society' concept that all people have the right to participate fully in all facets of society to the maximum extent they are able. A key strategy for applying this concept to social security recipients is to ensure that they have access to the training, education or rehabilitation necessary to equip them for workforce participation.

The Disability Reform Package (1991)

The Disability Reform Package was introduced in response to the steady increase in the number of people dependent on disability-related payments which has been apparent since the early 1970s for a number of reasons, including their use as a proxy for early retirement when unemployment was high. A major objective of the Package was to improve the participation of people with disabilities in employment, education and training and thus reduce their dependence on income support. A key feature is the linking of Disability Support Pension through disability panels to rehabilitation, and to training and labour market programs, provided by the Departments of Human Services and Health (HSH) and of Employment, Education and Training (DEET) respectively. From 1991, Sickness Allowance has been generally limited to 12 months duration (extended to 24 months in special circumstances) with special emphasis placed on rehabilitation to assist allowees to return to work.

The Jobs, Education and Training Program (1989)

The Jobs, Education and Training Program (JET) was introduced with the aim of increasing sole parents' incomes and reducing their dependency on social security by encouraging and facilitating workforce participation. Through a network of JET Advisers located in DSS and close links with FISH and DEET, JET provides improved access by sole parent pensioners to child care, education, training and employment opportunities.

The Newstart Strategy (1989)

The Newstart Strategy comprises a comprehensive package of programs designed to encourage and assist unemployed people to regain employment, establish economic independence and actively participate in the process of social and economic change. Under the program DSS provides income support while DEET provides assistance with job search activity and access to labour market programs, education and training. A number of special measures are available based on the age and types of disadvantage suffered by Newstart customers and varying according to their needs. The long-term unemployed and those at risk of being so are given particular attention.

Measures announced in The White Paper on Employment and Growth (1994)

Continuing concern during the early 1990s about high levels of unemployment and the impact of the latest recession led to a thorough and comprehensive review of the factors that have made the problem so intractable here and elsewhere in the developed world. The outcome of this was the Government's *Working Nation White Paper on Employment and Growth* released in April 1994. The White Paper contained a number of initiatives in the social security area to be implemented from July 1995, including:¹⁷

- the introduction of Parenting Allowance;
- the restriction of the non-activity tested Partner Allowance to dependent partners of income support recipients born before July 1995 who do not have dependent children and who have no recent work experience;¹⁸
- restructuring of the income test for recipients of unemployment allowances to provide improved incentives for them to undertake part-time or casual work; and

17 The White Paper also dealt with microeconomic reform, policies for industry development, reforms of training and labour market assistance and regional development strategies. A key feature of the labour market assistance reforms is the introduction of the Jobs Compact, under which those who have been on unemployment allowances for 18 months or more are guaranteed a (genuine) job, secured if necessary by a government wage subsidy.

18 Previously Partner Allowance was available on a non-activity tested basis to all dependent partners of income support recipients. Partners born in July 1955 or more recently will have to qualify for a payment in their own right, generally Job Search or Newstart Allowance if they have no dependent children and Parenting Allowance if they are caring for dependent children.

- the restructuring of the income test for a couple on unemployment allowances whereby, instead of the combined income of the partners being taken into account, each partner (up to a specified income level) is income tested individually. The reform will increase the incentive for both partners to undertake work.

Developments in occupational superannuation

Since 1983 superannuation arrangements in Australia have undergone significant reform resulting in a major extension of coverage and many more people keeping their superannuation intact until retirement. This is a response in particular to the ageing of the population and reflects a recognition that the cost of age pensions paid at current levels and under existing conditions could become excessively burdensome in the longer term.

Before 1983, superannuation was generally seen as a tax-advantaged form of remuneration for a minority of generally higher paid employees. Reforms commenced with the move to tax more heavily lump sum superannuation taken before age 55 to discourage people from accessing their superannuation before retirement. At the same time, the growth of roll-over funds was encouraged which meant that, on leaving jobs, people had somewhere to hold their superannuation accumulations until retirement without taxation penalty.

In the mid-1980s the trade union movement also took up the issue of employer sponsored superannuation which resulted in superannuation being attached to industrial awards. Between 1987 and 1990, as individual industrial award agreements were negotiated and ratified, superannuation coverage of employees nearly doubled. In the private sector, where superannuation coverage had

traditionally been low, it increased from 31 per cent in 1987 to 67 per cent in 1991.

The Superannuation Guarantee and other reforms

In July 1992 the Government introduced the Superannuation Guarantee to provide:

- a major extension of superannuation coverage to employees not covered by award superannuation;
- an efficient method of encouraging employers to comply with their obligation to provide superannuation to employees; and
- an orderly mechanism by which the level of employer superannuation support can be increased over time, consistent with retirement incomes policy objectives and the economy's capacity to pay.

The Superannuation Guarantee is now an integral part of Australia's retirement incomes policy and is designed to ensure that employers provide a prescribed minimum level of superannuation support for employees. Overall, around 90 per cent of employees are now covered.

The Superannuation Guarantee will enable many employees to accumulate savings that will contribute to a higher standard of living in retirement than would otherwise be achieved living on a social security pension alone. For large employers, the minimum support is now 5 per cent of earnings and this will be progressively increased to 9 per cent by the year 2002. Small business employers have slightly lower rates of contribution over the first few years of the scheme.

Superannuation Guarantee contributions are typically paid into 'accumulation funds' - funds where the employer and/or employees contribute a set amount that accumulates and earns income for the benefit of the member. Members carry the investment risk and receive only what is contributed, plus interest and less costs. There is no defined benefit.¹⁹

In addition to the Superannuation Guarantee, the Government has decided to boost superannuation by requiring employee contributions. In May 1995 the Government announced that it would:

- support the phased introduction of a requirement for employees to contribute 3 per cent of their earnings to superannuation by the year 2000; and
- make means-tested Government superannuation contributions matching those made by employees (and the self-employed) up to a maximum of 3 per cent by redirecting tax cuts which were announced in 1992.

Together with employer contributions required under the Superannuation Guarantee, the measures will result in employees having the equivalent of up to 15 per cent of their earnings directed towards their retirement savings from 2002.

Regulations related to vesting, preservation and portability standards have also been tightened over the last decade. The Government has indicated that it intends to phase in a higher preservation age (the minimum age at which a member of a superannuation fund can claim full entitlements), raising it from 55 to 60 for persons born after July 1960. In addition, special arrangements are to be introduced to ensure that part-time and casual workers putting small amounts into a number of different funds do not have the value of their contributions eroded by administrative fees. All these changes will increase the extent to which superannuation benefits are available in retirement and reduce dependence on the Age Pension.

Impact of superannuation

The trend toward a greater proportion of retirees attaining a higher standard of living in retirement as a result of superannuation savings is reflected by the contrast

19 Accumulation funds can be distinguished from 'defined benefit funds' - funds which agree to pay a member a fixed amount of money that is (usually) linked to years of service and salary level. The employer carries the investment risk and often contributes a substantial proportion to final payments. Most older public service and senior management schemes are defined benefit schemes, or in some cases hybrid schemes, which can provide both lump sums and indexed pensions. Many defined benefit schemes have now been closed off to new members, with new employees being offered membership of accumulation schemes.

between existing age pensioners and new entrants. Of current pensioners, around 67 per cent are in receipt of the maximum rate of Age Pension, whereas only 36 per cent of new entrants are in receipt of this rate.

Although the trend is expected to accelerate when the Superannuation Guarantee becomes mature, an adequate Age Pension will remain the cornerstone of Australia's retirement incomes policy and will continue to be available as a safety net to people who are unable to provide sufficiently for their own retirement. It will particularly benefit women, who not only on average live longer than men but also tend to have a lower participation in the labour force and lower earnings.

It is estimated that the new measures will contribute to a net increase in national savings of around 1 per cent of GDP per annum by 2005 rising to around 1.7 per cent of GDP by 2020 (Willis 1995).

Superannuation taxation arrangements

In 1993-94 the value of tax concessions for superannuation was estimated to be in the order of \$A5.6 billion. Concessions include a reduced rate of tax (15 per cent) for the income of complying superannuation funds, tax deductions for contributions by self-employed people and employees who receive no employer financed superannuation contributions, a tax rebate for low and middle income employees in respect of personal contributions and tax rebates for superannuation pensions received from 'taxed' superannuation funds.

Only benefits up to certain limits are supported through tax concessions. The limit for total retirement income is \$A800 000 and for lump sums \$A400 000. To qualify for the higher (pension) limit, a person must take at least 50 per cent of their superannuation benefits as a pension or annuity. Excessive lump sum benefits are usually taxed at the highest marginal rate of personal income tax. Excessive proportions of any superannuation pensions are not rebatable and are therefore taxed at the individual's marginal rate of tax.

6. FUTURE DIRECTIONS AND CHALLENGES: AUSTRALIA

This section looks briefly at the future of the social security system in Australia and the extent to which the financing mechanism can contribute to meeting the demographic, economic and social challenges which will arise.

In the face of these challenges, a number of directions for reform are being given attention by the Government. These were taken up in a paper entitled 'Beyond the Safety Net: The Future of Social Security' released by the Minister for Social Security, the Honourable Peter Baldwin, MP, on 23 March 1995.

The directions for reform currently being examined fall under four main categories: simplification of the social security system; customisation of payments; adequacy of payments; and broadening of community services.

Simplification

Recent years have seen the introduction of new social security programs, more flexibility in the conditions under which payments are made and greater targeting of payments. The end result has been a system which has become very complex. This complexity makes the system as a whole more difficult for staff to administer, more difficult for customers to deal with and less intelligible to the general public. Distinctions between categories may lead to perceptions that some groups are unjustifiably treated more favourably than others. These in turn may reduce compliance among clients and threaten public support for maintaining current levels of expenditure.

DSS has been giving consideration to how the social security system as a whole can be improved. The overall aim is to simplify the basic structure of entitlements, but to add a degree of flexibility so that customers can tailor the delivery of those entitlements in ways that best suit their individual circumstances. One idea is to move to a single payment structure for people of workforce age with the main differentiation being between those required and those not required to seek work as a condition of eligibility.

Customisation of payments

There is scope for increasing flexibility in the delivery of social security payments so enabling recipients to have greater control over their finances and to structure their pattern of receipt of those payments to better reflect their financial needs. DSS is currently exploring a range of possible delivery options including the payment of significant lump sum advances, variable payments nominated by DSS customers, and (in the pensions area) variable arrangements which might produce, for example, a steady income stream, deferment of pension entitlement or purchase of a pension.

Adequacy of payments

Economic and demographic changes over the last two decades have increased pressure on the Government to limit growth in the rates of social security payments to avoid increasing outlays while at the same time creating grounds for higher rates to ensure that the position of social security clients relative to the working population does not fall. These conflicting influences have increased the need for a systematic and rigorous approach to assessing the adequacy of social security payments.

DSS has recently undertaken a wide ranging survey of possible approaches to improving the assessment of the adequacy of income support payments. The purpose was to consider options for increasing the quality and range of information upon which the Government can draw in setting and evaluating payment rates. Subsequently, a program of commissioned research, designed to prepare comprehensive and contemporary individual and family budget standards for Australia and to explore the possible use of deprivation standards in assessing payment adequacy, was commenced.

Broadening of community services

DSS is undertaking a 'Community Research Project' which is looking at whether, and how, it should broaden the range of services it provides or, alternatively, support services based in the community. Underpinning the project is an acknowledgement that quality of life is not a function only of income support - other areas of activity such as social participation, having access to information, reducing costs and the informal labour market can also make a legitimate contribution to living standards. The project is also designed to provide individuals and communities with the opportunity to pool their resources in pursuit of their own goals. Services being tested in the Community Research Project are based in the community and rely substantially on a self-help approach.

Financing and the future

The general revenue system of financing social security has contributed in the past, and will continue to contribute, to the Government's ability to reform payment arrangements. As the pace of change in the external environment grows at an increasingly rapid rate, it is the flexibility of the system to respond to these changes that is important. It was argued that this flexibility is perhaps the most important advantage which a general revenue financing approach has over a social insurance approach. Politically, with the semi-contractual relationship inherent in a contributory system, it is much more difficult to make changes to arrangements, particularly where a group will be disadvantaged vis-à-vis another group within the system. Thus changes such as those identified involving the structure of payments, the method of payment (such as lump sums instead of regular payments), adjustments to levels on the basis of perceived need and extension of services (if this required some compensating reduction in cash paid) would be considerably more difficult to introduce under social insurance arrangements.

7. SUMMARY AND CONCLUSIONS LESSONS TO BE DRAWN FROM THE AUSTRALIAN EXPERIENCE

It is evident from the historical development of social security in Australia that the introduction of a social insurance system of public income support has been canvassed on a number of occasions but has always been rejected in favour of a system financed from general revenue and paying benefits to all permanent residents who require assistance. Social insurance is not in the platforms of any political party in Australia at the present time. It should be recognised, however, that private occupational superannuation paying contributions-based benefits is a large and rapidly growing element of social protection in Australia and that other elements of social protection also contain elements of social insurance.

The paper provides an assessment of the relative merits of general revenue and social insurance financing of public income support. The comparison is largely with schemes financed on a contributory PAYG basis as this is the predominant method of financing in OECD countries.

It is argued that general revenue financing has advantages over contributory PAYG financing in terms of poverty alleviation, the treatment of disadvantaged groups and fiscal policy flexibility and that it is less likely to have the unintended income redistributive problems of such schemes. There is insufficient evidence to conclude that one or the other financing method is superior in its impact on savings and investment or in the extent to which it creates disincentives to work or to evade/avoid taxes. Social insurance systems may well generate greater taxable capacity and therefore greater potential social security spending but the extent to which the additional funds can be used to assist the poor is questionable.

It is evident that social insurance systems are better in terms of providing benefits with high earnings replacement rates. However, high earnings replacement rates are not a primary objective of the social security system in Australia (occupational superannuation and private saving play this role). On the other hand poverty alleviation has always been one of the major objectives of social insurance schemes in the OECD countries and is the main objective of the Australian social security system.

Fully (or partially) funded social insurance is a solution often recommended to deal with the problems of contributory PAYG financing. Funded schemes might remove the unintended income distributional problems and may have a more positive impact in terms of promoting saving and investment. However, they would not deal any better with the other problems identified and would also be likely to involve greater administrative costs than both contributory PAYG and general revenue financing. Nor do fully funded schemes provide much overall flexibility which is perhaps the principal advantage of general revenue financing.

Australian experience with general revenue financing over the last two decades has been reviewed in the paper. The Australian social security system has had to cope with similar pressures to those faced by other OECD countries in the period, in particular an ageing population, increased unemployment, changes in work patterns and an increasing diversity in family structures and life patterns. These pressures have led to demands for increased social security coverage of the population together with increases in the levels of payments at a time when Australia's economic circumstances required reduced public spending.

The Federal Government's response to these pressures has been to increase social security coverage of the population by introducing new benefits, to extend eligibility for existing benefits and to increase the adequacy of payments. This has been achieved while maintaining indexation for all income support payments, making a number of ancillary payments subject to indexation and providing real increases on an ad hoc basis. These changes have been affordable because they have been accompanied by significant savings measures - benefits have been better targeted to those in need by restrictions on eligibility, the imposition of (or increases in the stringency of) income and assets tests, tighter fraud control, better debt recovery and more efficient administration. In addition a number of 'Active Society' measures have been introduced designed to ensure that a range of social security recipients have access to the training, education or rehabilitation necessary to equip them for workforce participation.

It is argued that the ability of the Government to implement significant reforms to enhance the public income support system, while at the same time introducing savings measures, has been facilitated by the capacity under a general revenue financed system to vary entitlements. This flexibility would be less likely to be available under a social insurance system with individually defined entitlements related to previous contributions and employment experience.

A further development in Australia has been the introduction of major reforms to private occupational superannuation, including a significant compulsory element. This has already resulted in large increases in the proportion of the population covered by occupational superannuation and in the level of entitlements and significant further increases will result in the future.

It is hoped that this comparison of the two major methods of financing and the account of the Australian experience will be useful to countries where their social security systems are in the process of development and reform. It is, of course, a matter for these countries to judge what, if any, elements of the Australian experience are relevant to them.

The findings of the 1994 World Bank report are of interest in this context. A conclusion of that Report is that a major problem with the large public retirement income plans under social insurance systems in OECD countries is that they seek to achieve two conflicting objectives, those of poverty alleviation and savings (income maintenance) within a single scheme. It recommends that countries adopt a 'three pillar' approach to old age protection: a scaled down compulsory public plan designed solely to achieve the poverty alleviation objective; a mandatory fully

funded private pension pillar to achieve the savings (and income smoothing) objectives; and a voluntary saving pillar to supplement the other two. In considering options for the smaller public pillar, the report sees considerable merit in the use of general revenue financing with either flat-rate or means-tested benefits. This blueprint for reform mirrors very closely the present Australian arrangement.

The World Bank's recommendations are consistent with a growing recognition that general revenue financing should have a greater role to play than hitherto in social security financing.

APPENDIX 1: SOCIAL SECURITY AND TAX

In examining methods of financing it is important to have regard to both the taxation and social security systems. Each is important in terms of a government's redistribution policy. This is particularly the case in Australia because of its particularly heavy dependence on a progressive personal income tax. This section concentrates on the personal income tax system.

Historically, the Australian personal income tax system contained a number of provisions designed to promote horizontal equity by recognising that taxpayers with family responsibilities have a reduced capacity to pay tax. In the mid- 1970s, tax provisions relating to the support of dependent children were abolished and replaced with cash assistance through the social security system. The primary rationale for this was to provide greater assistance to low income families who were not able to benefit fully from the tax provisions. More recently, the provisions for taxpayers with a dependent spouse and children were also replaced, in most cases, by a social security payment.

While these changes suggest a move away from using the tax system as a delivery mechanism for assistance, other changes have increased the interaction of the social security and tax systems in Australia. Some important issues are continually under review.

Taxation status of social security payments

Prior to 1969, pensioners were exempt from income tax. The Age Pension was made taxable in conjunction with moves to introduce a universal Age Pension system in 1973. The Government decided to offset part of the cost of abolishing the income test for those aged 75 and over, and reduce the extent to which high income groups would benefit, by taxing the pension. These moves were intended as the first step towards a universal income support system in which all pensions would be free of any means test but would be subject to income tax. By 1976 all pensions and benefits, with the exception of Invalid Pension (since renamed Disability Support Pension), had become taxable. However, additional payments such as Rent Assistance, Guardian Allowance and additional payments for children remain tax-free.

In 1976, the income tax threshold was significantly higher than the standard rate of pension or benefit. However, the indexation of social security payments meant that by 1981-82 the value of the pension exceeded the tax-free threshold and thus pensioners with no private income would have faced a tax liability. Consequently, an income-tested pensioner rebate was introduced for that financial year. In the absence of any significant increases in the tax threshold, the rebate has continually been increased and is now over \$ 1 000 for a single pensioner. Rebates have also been introduced for other categories of social security recipients.

As a result of these developments, the social security system is currently characterised by a mix of taxable and non-taxable payments and a complex interaction between the social security income test and the income-tested tax rebates.

Effective marginal tax rates

The combined effects of the means test on social security payments, the income test on social security rebates and ordinary income tax lead to many social security recipients facing high effective marginal tax rates (EMTRs) which are generally significantly higher than the highest marginal income tax rate. Exempting the payments from income tax, while resulting in a simpler system, would increase some EMTRs while lowering others.

The high EMTRs associated with the Australian social security system are largely the inevitable consequence of tightly targeting, through means testing, income support entitlements. The effect of these EMTRs on labour force and investment behaviour is a matter of some debate.

There has certainly been a steady trend in Australia towards an increasing proportion of clients combining social security income support with income from other sources, probably driven by both changes in labour markets and by the greater wealth of recent retirees compared with previous cohorts. The extent, if any, to which this trend has been slowed by the disincentives presented by a targeted system of income support is unknown. In any case, an analysis based purely on effective marginal tax rates may not capture other important elements in the decision to work or save, such as the size of the income range over which high EMTRs apply (best captured by measuring effective average tax rates), the costs of working and, for investment behaviour, any effects on risk aversion of having a 'safety net'.

Differences in assessment procedures

Other aspects which can affect pensioners are the differences between the social security and tax systems in the income unit and time period for assessment.

Social security entitlements are based on the needs and means of the person at the time of payment. The social security system is generally unconcerned with a person's finances and circumstances prior to eligibility. Assessment in the case of married couples is based on husband's and wife's income, recognising the probability that spouses will support one another.

Tax liability, on the other hand, is based on a person's capacity to pay. Assessment is based on the financial year and is unconcerned with the taxpayer's circumstances at the time of assessment. The unit of assessment is the individual.

Because the pension system is categorical and focused on immediate need, it is generally indifferent to which of a couple receives income, while the amount of tax paid can differ significantly depending on which member of a couple actually received income.

These differences between the tax and social security systems are confusing to many pensioners who are, or think they may be, affected by the two systems. Such differences can also make it extremely difficult to integrate tax and social security to

reduce high effective marginal tax rates and simplify procedures. The interaction of the two systems is constantly under review and a number of options to improve current arrangements have been considered. However a recent proposal to remove age pensioners from the tax system was not proceeded with because of its significant cost and because of issues of equity between pensioners and non pensioners with similar levels of income.

APPENDIX 2: THE AUSTRALIAN SOCIAL SECURITY SYSTEM: A BRIEF DESCRIPTION OF THE MAIN PAYMENTS

Pensions

All pensions are paid subject to an income and an assets test (with the exception of the Disability Support Pension paid to people who are permanently blind). All pension rates are adjusted six monthly according to increases in the Consumer Price Index (CPI). Additional Family Payment is payable to pensioners in respect of dependent children under the age of 16.

The **Age Pension** is payable to men at age 65 and to women at age 60. Age Pension age for women is progressively being raised to 65 over a 20 year period.

The person claiming the Age Pension must have resided in Australia continuously for 10 years. A person with less than 10 years' continuous residence, but with broken periods of residence totalling 10 years and one period of which is at least five years, may also qualify.

The **Disability Support Pension** is payable to men between the ages of 16 and 65 and women between 16 and 60 years who have a physical, intellectual or psychiatric impairment of 20 per cent or more and a continuing inability to work.

Wife Pension was previously available to women with Age or Disability Support Pensioner partners and who did not qualify for another social security payment in their own right. No new grants of Wife Pension have been made since 1 July 1995, although entitlement to the pension will continue for existing recipients.

Carer Pension is payable to a person who is the carer of a person who has a severe disability requiring full-time care and who, as a result of providing this care, is unable to support him/herself from employment and is not in receipt of another social security payment or veteran's pension. The care must be provided in the disabled person's home with the carer living in the same home or an adjacent home.

Sole Parent Pension is payable to sole parents who have at least one dependent child under 16 years in their care. Sole Parent Pensioners must take reasonable steps to obtain child support from the surviving parent(s) of their child/children. No period of prior residence in Australia is required to qualify for this pension if the person becomes a sole parent in Australia.

Allowances

All allowances are paid subject to an income test and an assets test. Rates of allowance paid to those aged 21 and over are adjusted six monthly according to CPI

increases, while allowances paid to under-21 year olds are adjusted annually. Additional Family Payment is payable to allowees with dependent children under the age of 16.

Job Search Allowance, Newstart Allowance and Mature Age Allowance provide income support to people who are unemployed. A range of conditions and circumstances determine when and for what periods these allowances are paid. The main features are as follows.

To qualify for **Job Search Allowance**, a person must be unemployed, aged 16 (or 15 in some circumstances) to 64 (male) or 60 (female), registered with the Commonwealth Employment Service (CES), be actively seeking and willing to undertake suitable paid work and be prepared to participate in training or work experience programs to improve the likelihood of employment.²⁰ Those aged 18 and over must have been registered with the CES for less than 12 months (after which time Newstart Allowance may be payable). There is a waiting period of 26 weeks after arrival in Australia before newly arrived migrants (apart from refugee and humanitarian entrants) are entitled to apply for the allowance.

Newstart Allowance is payable to an unemployed person, aged 18 to 64 (male) or 60 (female), who has been registered with the CES for more than 12 months and who is prepared to enter a Newstart activity agreement and comply with or vary an existing agreement. A Newstart activity agreement, which is negotiated between the client and the CES, sets out the activities which the client has agreed to undertake in order to improve his/her employment prospects.

Mature Age Allowance is payable to long term unemployed people between the age of 60 and Age Pension age. To be eligible, claimants must have been registered with the CES for the 12 months before claiming the allowance (but are not obliged to remain registered with the CES once they are in receipt of the allowance), must have been receiving an income support payment for 12 months or more and must satisfy similar Australian residence criteria to those which apply to the Age Pension.

Sickness Allowance is payable to people between the age of 16 and Age Pension age who are temporarily incapacitated for work because of sickness or an accident and who have suffered a loss of income as a result. The allowance usually may be paid for up to 12 months, but can be extended for a further 12 months in special circumstances. As for Job Search Allowance, there is a waiting period of 26 weeks after arrival in Australia before newly arrived migrants (apart from refugee and humanitarian entrants) are entitled to apply for the allowance.

²⁰ Since January 1995, Job Search Allowance has no longer been payable to those aged under 18, except for existing cases. Unemployed 16-18 year olds (and certain 15 year olds) now qualify instead for Youth Training Allowance, paid by DSS on behalf of DEET.

Partner Allowance is payable to the dependent partner of a person receiving Job Search, Newstart or Sickness Allowances or Special Benefit (see below). Claimants must be Australian residents, be born before 1 July 1955 and, in the case of new applicants from 1 July 1995, have no recent work force experience.²¹ (If a couple has dependent children under 16, the partner would qualify instead for Parenting Allowance.)

Family Payments

The main Family Payments are Basic Family Payment and Additional Family Payment. Family Payment recipients must be Australian residents or holders of a refugee temporary entry permit.

Basic Family Payment is payable to a parent, guardian or institution caring for a child who is under 16 (or to the end of the year the child turns 18 in the case of fulltime secondary students not receiving another income support payment). It is paid to the main carer of the child (usually the mother) subject to a parental income and assets test. The rate of payment is dependent on family size rather than the age of the child. It is adjusted annually according to increases in the CPL.

Additional Family Payment is payable in addition to Basic Family Payment to low income families with dependent children. It is paid automatically to parents or guardians in receipt of a social security income support payment and subject to income and assets tests in the case of low income working families.

Parenting Allowance is payable on an income and assets tested basis to the member of a couple who provides care for at least one dependent child under the age of 16, where at least one member of the couple is unemployed. It is paid in lieu of Partner Allowance to the partners of pensioners and allowees with dependent children under age 16.

Special Benefit

Special Benefit is a discretionary payment available to people in severe financial hardship who are unable to earn a sufficient livelihood for themselves (and their dependants) by reason of age, physical or intellectual disability or domestic circumstances or for any other reason over which they have no control and who are not receiving any other form of income support. The applicant must be an Australian resident or the holder of a special entry permit to Australia (as in the case of refugees). Payment of Special Benefit is subject to a very strict means test.

²¹ Partner Allowees who were in receipt of payment prior to 1 July 1995 will continue to remain eligible for Partner Allowance if their partner returns to work, for as long as the couple's joint income remains below the cut-out point for payment of part-rate allowance. (See also the later section dealing with the allowance income test.)

Rent Assistance

Rent Assistance is provided as an additional payment to recipients of pensions, allowances, benefits or Additional Family Payment who pay rent to private landlords for accommodation. Rent Assistance is payable if the amount of rent paid exceeds a specified threshold. It is not subject to a separate income or assets test.

APPENDIX 3: CURRENT MEANS TESTING ARRANGEMENTS

The main means test provisions for the major social security payments are described below. All payments (with the exception of the Disability Support Pension paid to people who are blind) are subject to both an income test and an assets test. For each of the payments described, there are 'hardship provisions' by which people with very low incomes, but whose assets would otherwise disqualify them from receiving a payment, may qualify for the payment under specified conditions.

Pensions

The rate of pension depends on an income test and an assets test. The pension is calculated under the two separate tests and the test which results in the lower rate of pension is the one which applies. The income and assets levels above which the pension is reduced are adjusted annually in line with the CPL

Income test

For every dollar that fortnightly income exceeds the allowable limit ('free area'), the single pension is reduced by 50 cents and the pension of each member of a couple by 25 cents. The free area for single pensioners is currently \$A90 a fortnight and for pensioner couples \$A1 56 a fortnight. The free area is increased by \$A24 a fortnight for each dependent child of the pensioner.

Under the 'pensions earnings credit scheme', pensioners not receiving regular additional income can allow their free areas to build up under a credit arrangement to a maximum of \$A1000 which can be used to offset the effect of the income test on their pension of, for example, irregular earnings from casual employment.

Assets test

The amount of assets pensioners may have before their pension is affected by the assets test differs according to whether they own their own home or not (the home itself is not assessed). The value of assets allowed under the assets test for single homeowner pensioners is currently \$A115 000; for single non-homeowners, it is \$A197 000; for homeowning pensioner couples, the combined limit is \$A 163 500; and for non-homeowning pensioner couples, it is \$A245 500.

For single pensioners, every \$A 1000 of assets over the limit reduces the pension by \$A3 a fortnight. For members of a couple, every \$A1000 of assets over the limit reduces each pension by \$A 1.50 a fortnight.

Allowances

Allowances referred to here include Job Search, Newstart and Sickness Allowances. As with pensions, the rate of allowance is dependent on both an income test and an assets test. Recipients aged under 18 may be subject to a parental income and assets test.

Changes were made to the income test provisions for people receiving Job Search or Newstart Allowances from 1 July 1995. These changes are intended to provide an additional incentive for unemployed people (including both single people and each member of a couple) to undertake casual or part-time work.

Income and assets tests

From 1 July 1995, the income test has changed in two important ways - unemployed recipients are able to earn more income before payments stop and the income test for couples has been changed from a joint to a modified individual income test.

The new allowance test includes a personal income test and a partner income test:

- the personal income test, which applies to both members of a couple in their own right, provides for a standard \$A30 a week free area, a 50 per cent taper for income between \$A30 and \$A70 a week and a 70 per cent taper for income over \$A70 a week until the cut-out point is reached; and
- the partner income test only starts to affect the allowance of the other member of a couple when the partner's income reaches the cut-out point (currently \$A236 a week). Once one client reaches the relevant cut-out point and goes off income support, his or her partner's payment is reduced by 70c for each \$1 of the working partner's income over the cut-out point.

(The remaining partner, if they had no personal income above the SAW a fortnight free area, could still receive part Partner/Parenting Allowance or Job Search Allowance/Newstart Allowance until the working partner's income exceeded about \$A840 a fortnight (without rent assistance or for couples with children) or \$A932 a fortnight for couples without children but with rent assistance.)

Under the allowance earnings credit scheme, allowance recipients and their partners are able to earn a moderate amount of income from casual or part-time work without it automatically affecting their allowance. In a similar way to the pensions earnings credit scheme, allowance recipients can build up a credit of their unused free area of up to \$A500 which can be used to offset the effect of casual earnings on their allowance.

The assets test on allowances uses the same dollar limits as the pensions assets test. However, above the specified amounts, whereas pensions are reduced below the maximum rate (as described earlier), allowances are no longer payable at all.

Special Benefit

Special Benefit is not payable when available funds and liquid assets of the applicant are \$A5000 or more. In cases of short-term need, the benefit is payable only if readily available funds do not exceed the equivalent of two weeks' benefit. There is no free area in the case of Special Benefit and any income received by the beneficiary is deducted on a dollar for dollar basis from the benefit.

Family Payments

Income and assets tests apply to the Basic Family Payment and the Additional Family Payment received by people not in receipt of a pension or allowance. Allowable income and assets levels for both family payments are adjusted annually in line with the CPL Entitlement to the payments is assessed for each calendar year, based on the combined taxable income of the couple in the financial year (1 July-30 June) that ended in the previous year.

Basic Family Payment is not payable when annual income exceeds \$A61 020 for a family with one child (increased by \$A3051 for each additional child) or when family assets (excluding the family home) exceed \$A559 250.

Additional Family Payment is reduced by 50 cents for every dollar by which annual taxable income exceeds \$A21 700 for a family with one child (plus \$A624 for each additional child). It is not payable when family assets (excluding the family home) exceed \$A376 750.

APPENDIX 4: EXPENDITURE PROJECTIONS

The Australian Department of Social Security (DSS) does not need to employ actuaries to undertake complex calculations to assess future social security expenditure. The methodology used to derive estimates of expenditure for all income security payments in Australia is built on a foundation of historical trends that link a range of interactive components and is relatively straightforward. Components are listed below.

- *The base* - This comprises historical data collected over time. These data encompass changes in customer characteristics and earnings attributable to movements in the economy and changes to eligibility.
- *Client numbers* - Forecasts of client numbers are undertaken three times a year in conjunction with ongoing monitoring of trends on a fortnightly basis. These forecasts take into account changes to the economy, the demographic profile of Australian society, eligibility, thresholds and administration. Exceptions to this procedure are forecasts of unemployment allowance numbers which are provided by the Department of the Treasury, based on econometric modelling.
- *Average rate of payment* - Historical expenditure trends divided by client numbers enable a pattern of average payments to be derived. Effects of influences such as indexation to the Consumer Price Index (CPI) and legislative changes are then added.
- *The CPI* - The estimates of expenditure on client payments reflect the forecast CPI factor for the current and future years and are updated as the actual CPI for each quarter becomes known.
- *Changes in government policy* - These changes are usually reflected in the build-up of estimates each year at Budget time or through Economic Statements. Budget measures may have the effect of changing both client numbers and expenditure.
- *Other factors* - Underlying trends in customer behaviour, which may be a reflection of changing values of society, are also taken into account. Such changes (for example, the slowing of the birth rate) can occur over long periods of time and have a long-term impact on expenditure.
- *Running costs* - Estimates of running costs and other services follow similar principles to those described above. Client forecasts form the basis of staffing and administrative funding requirements. A major difference to benefit payments is the application of a price adjustment factor other than the CPI the Australian Government Final Consumption Expenditure deflator - to adjust running costs.

DSS prepares estimates using this methodology and then seeks to negotiate and agree the estimates with the Department of Finance. Ultimately the Department of Finance is responsible for the forward estimates of all Government departments. The estimates are formally reviewed at the time of the preparation of the Budget and Additional Estimates appropriation bills each year.

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