

# **The Welfare Expenditure Debate: “Economic Myths of the Left and the Right” Revisited**

## **DRAFT**

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### **1. INTRODUCTION**

A central activity of government in all developed countries involves redistributing income through the social security and taxation systems, and through direct provision or funding of public services, such as health, education and child care. In analysing the effects of these policies, an important area of debate is whether the redistributive objectives of government could be achieved more efficiently and effectively through alternative policies. Much of this discussion concerns the presumed trade-off between growth and equity; that is, whether policies to reduce poverty and inequality have negative impacts on overall economic growth. In this context, reference is often made to the “affordability” of social expenditure and the effects of benefits systems and the taxes and contributions used to finance them on incentives to work and save.

The international literature on these issues is large, and the debate has gone on for a considerable period of time. The debate is complex, because there are arguments that greater inequality can be either beneficial or damaging to growth, with the same applying to higher social expenditures (Arjona, Ladaique and Pearson, 2002). One view is that of Schuknecht and Tanzi (2005), who argue that “... high levels of public spending create inefficiencies on the tax side – because they require higher tax rates – and on the expenditure side – because they require large bureaucracies, and because, from the individual citizen’s point of view, government services often have a zero (or at least a very low) price thus stimulating greater demand for them. Finally, high public spending may lead to macroeconomic difficulties when it is partly financed by fiscal deficits” (2005, p. 9). They also argue that lower public spending seems to be associated with better or more desirable social and economic outcomes, and that “a level of public spending somewhere between 30 and 35 percent of GDP was likely to provide the

government of a country with resources sufficient to support all the activities that genuinely merit public support” (2005, p. 8).<sup>2</sup>

In contrast, Lindert (2005) argues that “OECD experience since 1980 does not show any negative effect of larger tax-financed transfers on national product. There are good reasons for this ‘free lunch puzzle.’ High budget welfare states feature a tax mix that is more pro-growth than the tax mixes of low budget America, Japan, and Switzerland. The high-budget states also have more efficient health care, better support for child care and women’s careers, and other features that mitigate the negative incentives on transfer recipients”(2005, p.1).

The Australian debate about these issues is similarly diverse, as well as long-standing, although aspects of the Australian controversy differ, because the Australian institutional context differs in important respects from those in other countries. In most countries of Europe, as well as in the United States and Japan, benefits are financed by contributions from employers and insured employees, and benefits are often related to past earnings. In contrast, in Australia and New Zealand, most benefits are flat-rate entitlements financed from general government revenue, with Australia going further than New Zealand in assets or income-testing these payments for those of age pension age. The usual rationale for this for this approach is that it provides the most efficient means of reducing poverty, by concentrating available resources on the poor (“helping those most in need”), while minimising adverse incentive effects by limiting the level of overall level of spending and taxes.

Just over 20 years ago, Fred Gruen (1982) reviewed debates about the level of welfare spending in Australia, noting them as being motivated on the one hand by the view that “more is better”, and on the other hand by the view that “too much” is dangerous. Specifically, his article discussed four issues: first, the adequacy or meanness of social security provisions in Australia; second, the behavioural effects of the benefit system; third, the redistributive effects of welfare provisions (“Are they [welfare provisions] ... largely random (or even worse do they benefit mainly the middle classes) or do welfare provisions reduce poverty and hardship?”); and fourth, the sustainability of existing

provisions over the long haul (1982, p. 208).

Despite Gruen's debunking of many assertions then made about the Australian welfare state, the debate continues – and still along much the same lines - either on the one hand that “more would be better” (because Australia is not spending enough) or that “too much is dangerous” (and Australia is already spending too much). For example, the Australian Council of Social Service (ACOSS) has argued that “comparison of our social security system with those of other wealthy countries finds that Australia's system is lean and mean. ... This is due to a combination of a relatively low proportion of people on benefits, relatively low payments, and stringent income and assets tests” (ACOSS, 2004). This characterization is similar to international assessments of the Australian welfare state, notably Esping-Andersen's ranking of Australia as a residual welfare state, providing the lowest level of de-commodification of any OECD country (1990, p. 52). Similarly, a Dutch study of “the worlds of welfare” concluded that “Australia has no collective social insurance schemes and is thus a textbook example of a liberal or residual system (Schut, Vrooman and de Beer, 2001, p. 26).

Other critics of Australian welfare arrangements take an opposing perspective and argue that we have a significant problem of welfare dependency and increasing welfare spending (Saunders, 2004a, 2004b). More recently, Saunders (2005a) has argued that the efficiency of welfare arrangements could be significantly enhanced without compromising poverty alleviation by reducing the “churning “of taxes and benefits, both at a point in time and over the life-cycle. Saunders argues that: “At least half of the \$175 billion of tax revenue spent on the welfare state last year will probably find its way back to the people who paid the money in. If we could eliminate this churning, it would release \$85 billion which could fund spectacular tax cuts without making anyone worse off. We could, for example, raise the tax-free income threshold to \$20,000 and combine it with a flat 10% income tax” (Saunders, 2005a).

This disparity of views is surprising, since the disagreement is not only about values – how much redistribution is socially and economically desirable, or whether the negative effects of welfare

spending on economic growth outweigh the positive benefits of reducing poverty - but it is also about issues of fact – how much is spent compared to other countries, how much has spending grown, how well is spending targeted?

In order to contribute to clarifying these issues, this article presents results from a number of recent OECD studies providing the most-up-to-date comparative information on the relative size and performance of Australian welfare arrangements.<sup>3</sup> The article looks at (a) trends in the level of social expenditure in Australia compared to other OECD countries, and explanations for differences across countries, (b) the distribution of benefits and the impact of social expenditure on income distribution, including the degree of “churning” of benefits (c) the level of benefit receipt among people of working age, and (d) the relative generosity of benefit entitlements. The article concludes with a brief summary and discussion of the conclusions that might be drawn from these comparisons.

## **2. COMPARING SOCIAL SPENDING IN OECD COUNTRIES <sup>4</sup>**

Comparisons of the level of social spending are one of the most common ways of comparing welfare states. Spending is often seen as an indicator of “generosity” or at least of “welfare effort”. Gruen (1982), however, noted that “the easy international comparison of expenditure on welfare as a percentage of GDP is a particularly poor way” of assessing whether Australian social welfare provisions are either adequate or mean (1982, p. 208). As pointed out by Ingles (1977), differences in levels of social spending across countries are associated with a number of factors substantially complicating interpretation of whether spending is “too high” or “too low”. These factors include:

- Problems of definition and measurement;
- Differences in “needs” in different countries;
- Interactions with the taxation system;
- Differences in the mix of instruments (public and private) in different countries;
- Differences in the structure of assistance, particularly the degree of targeting.

As will be shown below, all of these factors have very significant impacts on relative levels of welfare state spending.<sup>5</sup>

### **Levels of gross spending**

Table 1 shows trends in gross social welfare spending in OECD countries between 1980 and 2001, plus a detailed breakdown of spending by main components in 2001. In terms of gross spending, the lowest level is in Korea which spends not much more than 5% of GDP; Mexico, Turkey, Ireland and the United States spend between 10 and 15% of GDP on social expenditure, while Australia falls into a disparate group spending between 15 and 20% of GDP, which includes Japan, Canada, the Slovak Republic, New Zealand, Spain, Iceland and Hungary. At the highest level of gross spending there is another disparate group of countries, with Austria, Switzerland, Belgium, Germany, France, Sweden and Denmark spending between 25 and 30% of GDP. For all OECD countries, the unweighted average level of spending in 2001 was around 21% of GDP, with Australia spending 18% of GDP.<sup>6</sup>

Australian gross public spending on social security and welfare is thus somewhat below average by international standards. But what does this mean? Does it mean that welfare arrangements in Australia are less generous than average? What are the explanations for lower relative spending? Are we comparing like with like?

How specifically is Australia different? Public spending on health care in Australia is slightly above the OECD average (and about the same as in the United States and Japan). It can also be calculated that in term of composition the main explanation for Australia's difference from the OECD average is relatively low spending on age and survivor payments. Spending on age pensions – even though it is the most significant cash benefit in Australia, as in most other OECD countries - was only around 60% of the OECD average, with only Ireland and Korea spending less (and New Zealand and Canada about the same). Some of this discrepancy is due to differences in demographic composition, as the share of people over 65 in the total Australian population is about 11% below the OCD average.

Spending on disability payments was 91 per cent of the average, and spending on unemployment payments was also over 90 per cent of the OECD average. Other spending categories – survivors, housing and low income are small fractions of the OECD average, but involve low levels of spending in most countries.

In contrast, gross spending on families in Australia was apparently more than 1.5 times the OECD average, with only Austria, Denmark, Finland, Luxembourg, Norway and Sweden spending more on benefits and services for families with children. However, a good deal of spending on families in these countries is spending on child care, maternity and parental leave, where Australia spends relatively little. Counting only spending on cash benefits to families with children then Australia spends around 3 times the OECD average, and six times what is spent in the US or 12 times what is spent in Japan.<sup>7</sup> To a minor extent this can be explained by differences in demographic structure – the share of children in the total population is about 6% above the OECD average. However, the most important reason why Australia appears to spend a relatively high amount on benefits for families is because assistance that used to be provided through the tax system before 1975 is now paid mainly through cash benefits. As discussed below, taking account of support through the tax system changes the picture significantly for some countries.

### **Trends in spending**

Between 1980 and 2001 gross social welfare spending in Australia increased from 11.3% to 18.0% of GDP, or by 6.7% of GDP (Table 1). In contrast, average spending for the 21 OECD countries which have complete time series increased from 17.7% to 21.9% of GDP. The increase in measured spending in Australia was nearly 60% higher than the OECD average, so that Australia rose from 64% to 82% of the OECD average.

What explains this apparently rapid increase? In a number of areas there were significant real increases, particularly in health care expenditure following the introduction of Medicare in 1984, and also in family payments following a range of reforms from the 1980s onwards. However, the single

most important factor is improvements in data. For the first time from 1990 onwards, OECD data for Australia include estimates of state and territory workers compensation, with estimated spending on this item being \$6.0 billion in 2001 (and zero in 1980). Further, from 1995 onwards spending on civil servants' pensions and lump sums were included for Australia for the first time, being \$9.3 billion in 2001.

A further factor is "the GST compensation effect". Australian welfare spending increased by around \$10 billion between 1999 and 2000, following the introduction of the Goods and Services Tax, somewhat more than the total increase between 1995 and 1999. At 1.1% of GDP this was also the largest change for that year of any OECD country. However, most of this increase was due to the indexation of pensions and benefits to compensate for the price effect of the GST, although there were real increases in family benefits.

These three factors – improvements in data in 1990 and again in 1995, plus the introduction of the GST in 2000 - account for 35% of the total increase in Australian social spending since 1980. If these effects were excluded then, spending on social protection in 2001 would have been 66% of the OECD average, a little more than in 1980. This implies that since 1980 Australian social spending has increased at roughly the same rate as the average for OECD countries, rather than substantially faster. But it also implies that Australian social spending was previously underestimated, as workers' compensation existed before 1990 and public service pensions before 1995, but were simply not being counted.

### **Net Social Expenditure**

The discussion above has referred to levels and trends in "gross" social spending. A number of recent OECD studies have fundamentally changed our understanding of the real size of social spending (Adema et al., 1996; Adema, 2001; Adema and Ladaique, 2005). The main implication of these studies is that accounting for private social benefits and the impact of the tax system on social

expenditure has a significant equalising effect on levels of social effort across OECD countries. Broadly speaking there are three instruments through which governments affect social expenditure through the tax system, the impact of which varies across countries and can be considerable:

1. *Direct taxation (including social security contributions) paid on cash transfers* are close to or exceed 2 percentage points of GDP in Austria, Belgium, the Netherlands and Norway, and are nearly 3.6% of GDP in Sweden and over 4% in Denmark, but are less than 0.25% of GDP in Australia, the Czech Republic, Japan, Korea, Mexico and the Slovak Republic (Adema and Ladaïque, 2005).
2. *Indirect taxation levied on goods and services bought by benefit recipients* is estimated to be much higher in European countries (over 3% of GDP in Denmark and over 2% of GDP in Austria, Belgium, Germany, Finland, France, Italy, Norway and Sweden) than in Non-European OECD countries (0.3% of GDP in the US, 0.6% in Japan, 0.9% in Canada and 1% in Australia).
3. *Tax breaks with a social purpose* (either tax advantages similar to cash benefits or tax concessions aimed at stimulating the provision of private social benefits) are of limited value in apparently high spending Nordic countries, but are worth close to 1% of GDP in Germany, France, Japan, Mexico and the US (but around 0.3% of GDP in Australia).<sup>8</sup>

Taking account of the role of the tax system substantially reduces measured expenditure in many high spending welfare states, but has little impact in Australia and actually increases spending in the US, and therefore generates greater similarity of spending totals across countries. Net public social spending in Denmark and Sweden is about 6 to 7% of GDP below spending levels suggested by gross indicators, while for the US, gross public social expenditure underestimates public social effort by more than 1% of GDP. Net social spending in Australia is around 17.1% of GDP, compared to gross spending of 18% of GDP, a difference of around 5%, compared to differences of 25% in Denmark and 20% in Sweden.

In addition, these studies point to the important role played by mandatory private social expenditures.

For example, income support for the sick in Australia is predominantly provided by employers through industrial awards that fall outside the definition of public spending, while in many other countries coverage is provided through the social security system (Castles, 1991). Adema and Ladaïque (2005) estimate that in 2001 net mandatory private social expenditure in Australia amounted to around 0.8% of GDP, the fifth highest level in the OECD (exceeded by Korea, Italy, Iceland and Norway and equal to Germany and Japan).<sup>9</sup>

To summarise, a more comprehensive and consistent approach to measuring social spending and spending trends suggests that Australia is closer to the OECD average than has been commonly thought, and has been for a considerable time. Just as significantly, the apparent gap between Australia and other “average” countries, and even the low spenders such as the United States, and the apparently high spending Nordic and continental European welfare states is much narrower than has been thought.

### **3. TARGETING, PROGRESSIVITY AND REDISTRIBUTION**

Views differ about how redistributive Australian welfare arrangements actually are. The Australian pension system has been described as "radically redistributive" by an American observer (Aaron, 1992). In contrast, Warby and Nahan (1998) describe the Australian transfer system as “a badly arranged, inefficient, expensive insurance market where risks and liabilities are very poorly connected”. Alternatively, Wicks argues that “the welfare system is highly redistributive, but it is wrong to assume that this distribution is from wealthy to poor households. A substantial amount of welfare is distributed to middle and high income households.”(2005, p. 9).

In considering which of these characterisations is more accurate, it is important to start by identifying the differing objectives of the welfare state and the different types of redistribution that are possible. In Australia it is common to see the main objective of the welfare state as being to take from the rich to give to the poor (the “Robin Hood” motive). However, the primary objective of social security

systems in most other OECD countries is to provide income maintenance or insurance in the face of adverse contingencies (unemployment, disability, sickness) or to redistribute across the life-cycle, either to periods when individuals have greater needs (for example, when there are children), or would otherwise have lower incomes (such as in retirement). Barr (2001) describes this as the “piggy-bank objective”.<sup>10</sup>

Life-cycle redistribution can occur – and may be most common – through instruments outside the government welfare state. For example, home purchase and ownership is strongly redistributive across the lifecycle, with families usually facing higher expenses of purchase while they are working and then benefiting from lower housing costs in retirement. Similarly, private health insurance, personal savings, individual pension plans and endowment insurance involve either self-insurance or redistribution across an individual’s or family’s own lifecycle, and usually provide no direct redistribution between income groups.

It is often taken for granted in Australia that because we have a targeted benefit system that is flat-rate and means-tested, that by definition it must be more redistributive than other systems. However, it is important to distinguish between targeting, progressivity, and redistribution. Targeting can be either a means of determining eligibility for benefits or determining the level of entitlements for those eligible. The Australian system is targeted to categories of people, such as the unemployed, people with disabilities and those over age pension age, but it is not a system that provides support to everyone simply on the basis of low income. Once people satisfy these categorical eligibility criteria, their level of benefits is then determined on the basis of income and assets tests.<sup>11</sup> Progressivity refers to the resulting profile of benefits when compared to private or disposable incomes – how big a share of benefits is received by different income groups – do the poor receive more than the rich from the transfer system? Redistribution refers to the outcomes of different tax and benefit systems – how much the benefit system *changes* the distribution of income.

There are various ways of measuring progressivity. Table 2 shows two measures. The final column

shows the ratio of benefits received by the poorest quintile of the income distribution compared to the benefits received by the richest quintile.<sup>12</sup> The higher this ratio the more “pro-poor” is the system rather than being “pro-rich”. It is readily apparent that on this measure, Australia directs relatively more of its spending to the poor than any other OECD country – and by a very wide margin. The average is 2.14, with the Australian ratio being 12.69, and the next most targeted being New Zealand, where the ratio is less than half of Australia’s level. In general, the most targeted systems are the English-speaking welfare states of Australia, New Zealand, Ireland and the United Kingdom (although in Canada and the United States, the ratio is below average), together with the Czech Republic, and Denmark, Finland and Norway (but not Sweden), and the Netherlands.<sup>13</sup>

This measure, however, suffers from the limitation that it is substantially determined by how much goes to the richest 20% of the population and ignores how much goes to the middle of the income distribution. In fact, in virtually all OECD countries, the middle 60% of households receive between 50 and 65% of all transfers, with Australia being towards the lower end of this at 56%, but with Denmark, Ireland, Portugal and Mexico having lower shares.<sup>14</sup> In this specific sense, Australia has roughly the same share of “middle class welfare” as most other OECD countries (although the absolute amount that goes to the middle class is less than in most countries, apart from those that spend less than Australia). What is unusual about Australia is the smallness of the share going to the richest 20% of the population, this being only 3% of all transfer spending. The only other countries where the rich benefit nearly as little from the transfer system are the Czech Republic, Denmark, Finland, New Zealand and the United Kingdom (where they receive between 6 and 10% of all transfer spending), and the Netherlands and Norway where they receive a little over 10%.

The main measure shown in Table 2 is a “quasi-Gini coefficient”. The Gini coefficient is the most common measure used in income distribution analysis, and is a better measure of inequality and of progressivity than quintile or decile ratios because it is based on the entire income distribution, not just the extremes.<sup>15</sup> The Gini coefficient usually varies between zero and one, or zero and one hundred. Where the Gini coefficient is zero there is complete equality – all individuals receive the same share

of income, and where it is 100 there is complete inequality – one person receives all the income. In Table 2, the “quasi-Gini coefficient” for transfers varies between minus 100 and 100. This is because the coefficient is based on comparing the share of social security benefits received by deciles ranked from the poorest to the richest. For most income components, the share of income increases for higher income groups; in the case of transfers, the coefficient is negative because the share of benefits received decreases as income increases in these countries. Therefore, negative numbers imply a more egalitarian distribution of transfers than positive numbers. It should also be noted that while the Gini coefficients for direct taxes are positive, taxes are deducted from incomes, so higher values will tend to be more equalising.

Table 2 shows the Gini coefficients for private income (“before” taxes and transfers),<sup>16</sup> disposable income, and direct taxes, and the quasi-Gini for transfers – total transfers and those received by persons of working age and those over 65 years. On this measure, Australia remains as having the most progressive distribution of benefits of any OECD country, although New Zealand, Denmark and the United Kingdom also have very progressive distributions. Australia also has the most progressive distribution of transfers to persons of working age (followed by the same group of countries as for the overall population); for persons of age pension age, Australia has the second most progressive distribution after Finland<sup>17</sup> - and other countries with particularly progressive distributions of transfers to people of pension age (values which are negative or close to zero) include Canada, the Czech Republic, Denmark, the Netherlands, New Zealand and the United Kingdom, all countries where a substantial or the sole component of the pension system is a flat-rate benefit.

Australia has the second most progressive distribution of direct taxes after the US, although the variation in tax progressivity is much less than the variation in transfer progressivity. In most countries for which taxation data are available, the Gini coefficient is over 40%; the exceptions being the Scandinavian countries and the Netherlands and Switzerland,<sup>18</sup> probably reflecting the role played by taxes in clawing-back benefit expenditure, as discussed above. A further factor to consider is that because direct tax systems are usually designed to be progressive – average tax rates increase as

income increases – the tax system will be measured as being more progressive in countries with more unequal distributions of income.

In considering these results it is also important to note that an apparently “regressive” benefit system can still redistribute income, so long as it is not as unequal as the “primary” income distribution. Thus, even though higher income groups receive a greater share of social security benefits than the poor in countries such as Austria, France, Greece, Italy, Portugal, Spain and Switzerland, these social security systems are still “pro-poor”. As can be seen in Table 2, the Gini coefficient for transfers is lower than the coefficient for private incomes in all OECD countries, so that social benefit systems redistribute income in all countries.

While Table 2 clearly establishes that Australia, in fact as well as theory, has the most progressive social security structure among OECD countries, this does not mean that Australia necessarily redistributes income more than all other OECD countries. The degree of redistribution achieved by a benefit system depends on the "quantum" of benefits (how much is spent) as well as the progressivity of the formula for allocating benefits (Barr, 1992). A means-tested program with a highly redistributive formula - such as Australia's - may achieve limited redistribution if spending is low. That is, while the Australian system is more targeted and progressive than others, it may not necessarily be as effective at reducing poverty or inequality. In contrast, it is possible that a high cost, earnings-related system may achieve greater redistribution by providing more generous basic benefits.

Table 3 takes account of this and provides a measure of net redistribution to the poor (i.e. this is a measure of how much tax and benefit systems reduce poverty, not how much they reduce inequality). This is calculated first by estimating how much cash transfers are as a percentage of household disposable income as measured in income surveys (the quantum).<sup>19</sup> The next stage is to calculate how much of this goes to the poorest 20% of the population (progressivity), with the next stage being to multiply the quantum by the progressivity of its distribution to calculate gross benefits to the poor. The same procedures are used to calculate how much direct tax is paid by the poor, which is then

subtracted from gross benefits to give net transfers to the poor. The results of these calculations are in column 7 of Table 3.

While total transfers between Australian households are the 7<sup>th</sup> lowest of these 27 countries, Australia directs a higher proportion of this to the poor than any other country, so that the gross amount received by the poorest 20% of Australian households is the 7<sup>th</sup> highest, and after deducting the share of direct taxes paid by the poorest 20%, Australia is the most generous to the poor of the 19 countries for which this calculation can be made (although not much more so than Belgium and Denmark). It can also be noted that the United Kingdom, Ireland and New Zealand also have above average generosity to the poor, while Canada and the United States are well below the average in terms of generosity to the poor (but Canada is twice as generous as the US). The final column of the table shows the implicit indirect tax rate that households might pay in different OECD countries; if this percentage was deducted from net transfers to the poor, then Australia would in relative terms become even more generous.<sup>20</sup>

The conclusion that can be drawn from these calculations is that even though Australia spends less than the OECD average on social security benefits, the formula for distributing benefits is so progressive – and the level of taxes paid by the poor is so low – that Australia redistributes more to the poor than any other OECD country (for which these calculations can be made). Shouldn't we then expect Australia to have less poverty than other OECD countries?

In fact, Förster and Mira d'Ercole (2005) estimate that poverty in Australia is slightly above the OECD average (11.2 vs. 10.4%). One reason for this apparent paradox is that the poorest quintile in Australia has the lowest share of earnings of any OECD country – 1.6% of total earnings compared to 4.5% for the OECD on average. Moreover, most other countries with targeted and redistributive transfer systems also have below average earnings shares held by their poorest quintile, with the earnings of the poorest quintile in the United Kingdom, Ireland, New Zealand and Belgium ranging between 3 and 3.3%. The implication of this is that in Australia and these countries, the strategy of targeting has meant that the poor are the beneficiaries of considerable redistribution, but that they remain poor

because of their low share of private income.

### **Churning**

Despite the highly targeted nature of Australia's benefit system, concern has been expressed about the possibility that households can be both recipients of welfare and taxpayers simultaneously, or that individuals pay taxes at some stages of their life-course that they recoup in benefits at other times (Saunders, 2005a, 2005b). This flow of transfers into households and taxes out of the same households has been described as "churning", and it is argued this may involve unnecessary administrative duplication, impose compliance costs on households, and reduce choice.

OECD (1998) provided early estimates of the level of simultaneous "churning" of direct taxes and transfers, covering 10 OECD countries in the mid-1990s. This analysis showed that Australia had lower "churning" than any of the other countries included, including Japan and the USA, with lower levels of social security expenditure than Australia.<sup>21</sup> This is likely to be the result of the very low share of transfers going to the rich in Australia, and the very low share of direct taxes paid by the poorest quintile.

Table 4 provides estimates of simultaneous churning for around 2000. Churning is calculated as the difference between direct taxes paid and cash transfers received by decile groups. Each income decile is identified as either net transfer recipients or net taxpayers. For net transfer recipients, the direct taxes paid are calculated as a percentage of disposable income; where deciles are net taxpayers, transfers are calculated as a percentage of disposable income. The level of churning is the average of these amounts across all decile groups, weighted by the decile shares of disposable income.

The implication of this is that where deciles are net transfer recipients it would theoretically be possible to reduce direct taxes paid and then reduce transfers correspondingly, without making them financially worse-off. At the other end of the income scale, it would be possible to reduce transfers received by net taxpayers, and then equally offset their direct taxes, also without making them worse-

off. In theory, both taxes and transfers could be scaled-back by the amount of "churning" without any change to the net redistributive impact of the two systems, and the same net redistribution could be achieved with a lower level of both transfers and taxes, making the system more "efficient".

Australia has the lowest level of churning of any country, at around 5.5% of disposable income (Table 4). Other countries with low levels of churning are New Zealand, Ireland, Japan, and apparently France, while the countries with the highest level of churning are Germany, Italy, Sweden and Switzerland. It should be noted, however, that the volume of churning would differ markedly if expressed as a percentage either of direct taxes paid in each country - also shown in Table 4 - or of transfers received.<sup>22</sup> This is because the countries with the highest level of churning also tend to have the highest level of spending and taxing. Table 4 shows that churning in Australia is equivalent to around 23% of direct taxes; while this is still the lowest level of any of these countries, there is some convergence – for example, the estimate of churning doubles for Sweden, but rises four-fold for Australia.

It could be argued that the problem of churning is in fact much worse than suggested by these figures (Saunders, 2005a). Indeed, for Australia, churning defined to include indirect taxes and non-cash benefits as well as direct taxes and benefits would be more than three times higher, or around 18 per cent of final income (Harding, Lloyd and Warren, 2004). The main factors associated with this higher churning are the weight of indirect taxes paid by lower income groups and the receipt of health and education benefits by higher income households. While comparable data are available for only a few OECD countries, it is likely even on this broader definition that Australia would still have comparatively low churning, because of the relatively low level of indirect taxes.

Is churning a useful concept in assessing the efficiency or effectiveness of the welfare state? In fact, there are reasons for thinking that the concept or at least the way it is measured may be misleading in important respects. For example, Table 4 shows that churning as a percentage of disposable income is relatively low in France, but as a percentage of direct taxes it is higher than any other country. Indeed,

these figures imply that France could completely abolish its income tax and employee social security contributions if it were somehow able to reduce churning to zero (and it was thought this was sensible policy). The explanation for this unusual result is that France relies heavily on indirect taxes – particularly employer social security contributions and VAT – rather than direct taxes, and indirect taxes are not measured in household surveys. As a result, on average, French households apparently receive more than three times as much in benefits as they pay in direct taxes; households in the Czech Republic and Portugal also receive more in benefits than they pay in direct taxes, while at the other extreme, households in the United States pay nearly four times as much in direct taxes as they receive in transfers. This is simply incomplete accounting of the welfare state. Given the differing weight of indirect taxes in OECD countries and the differing role of non-cash services, these results suggest that estimates of churning restricted to direct taxes and cash benefits should be treated with extreme caution.

A further measurement issue is that these estimates are calculated by comparing average benefits received and taxes paid by decile groups; but it is possible that half the households in a decile pay all the taxes and the other half receives all the benefits, without any overlap between them. While this is not particularly likely, it means that the level of churning estimated above is an upper limit. Comparisons across household types rather than deciles have similar problems. For example, Saunders (2005, p. 9) claims in relation to Australian couples with pre-school children that “... for all the huffing and puffing of the giant government bureaucracies which were required to process these money flows, the net result [of the welfare state] was an average adjustment to these families’ total incomes of just minus 7%...” However, this treats all families with pre-school children as if they were in exactly the same situation and ignores redistribution between these families. In summary, a more accurate estimate of the level of churning would require the analysis of individual households rather than decile groups or broad family types.

A further issue is that estimates of churning are based on analysis of household incomes, but the income tests in the Australian social security system are based on “income units”, the nuclear family.

A greater prevalence of families sharing households will increase the level of churning – for example, a retiree living with adult children or an unemployed youth living at home count as transfer recipients in households of net taxpayers. From a purely measurement perspective, it would be possible to reduce churning if these beneficiaries moved to separate households. Policies to encourage this would probably neither be economically efficient nor socially desirable. In this context, some cross-country differences in churning levels are due to differences in household living arrangements rather than in the efficiency of social security systems. For example, a relatively high proportion of Japanese retirees live with adult children, and high proportions of households in Southern Europe contain youth still living at home.

The term “churning” itself is an example of “persuasive labelling”; it gives the impression that what is happening is haphazard or unplanned, or is the result of badly designed or irrational policies. But churning may result from intentional policy changes designed to reduce poverty or promote economic efficiency. For example, the July 2000 reforms to the Australian taxation system involved the introduction of the goods and services tax and a compensation package of increased benefits and family payments. Since one of the major components of “churning”, broadly defined, relates to the indirect taxes paid by the lowest 60 per cent of households, these reforms undoubtedly increased churning. However, the objective of reform was to increase economic efficiency while protecting low-income groups from the adverse effects of higher prices. A similar example arises in the case of New Zealand, where measured churning is higher than Australia because most benefits are “grossed-up” before payment and then subject to withholding of income tax. This procedure increases measured churning, but it imposes no administrative burdens on households, and it promotes horizontal equity.

Churning is not a measure of economic efficiency. In the case of family payments, it would be possible to replace the present cash payments with refundable tax credits, reducing both the level of transfers and taxation. But if the parameters of the tax credit were the same as the cash transfer, it would simply reproduce the pre-reform pattern of effective marginal tax rates. It is difficult to see that there would be significant efficiency gains in such a change, even if there were presentational

advantages.

It is also important to emphasise as the OECD (1998) points out that while some policy changes could reduce churning they would not leave households unaffected. An example is publicly funded medical care, access to which depends on health status rather than income. In such cases, reducing the level of churning would change the distribution of income. Assessment of the desirability of these policy changes would need to take account of these distributional effects, and not simply whether the system appeared to be more efficient.

Moreover, Saunders (2005a, 2005b) goes further than simply advocating a reduction in simultaneous churning, but also puts forward proposals to dramatically limit lifetime churning. Effectively, this would involve attempting to completely remove the lifecycle redistribution component from direct government policies and making them part of “private sector” activities, although as this would involve mandatory private savings accounts to cover unemployment, health care, education and pensions it is debatable whether the result could be regarded as privatisation, since it would require a significant extension of the regulatory role of the state. Given length constraints for this article it is difficult to address this approach in detail, although a comprehensive discussion of the “piggy bank” objective of the welfare state can be found in Barr (2001).

In brief, there are obvious difficulties with this policy approach. Indeed, it is virtually impossible to imagine that a government could make the changes envisaged by Saunders (2005a, 2005b), without significantly changing the distribution of income. For example, Saunders (2005a) argues that it would be possible to raise the income tax threshold significantly and have a very low rate of tax above this if churning could be halved. However, for the bottom 40% of households, income taxes are a relatively unimportant component of churning – indirect taxes are nearly three times as burdensome. This policy proposal would therefore leave one of the most significant causes of churning unamended. Why cut income taxes rather than indirect taxes? Alternatively, would it be sensible to abolish all indirect taxes? How could low income groups be relieved of their indirect tax burdens? Clearly the

most sensible approach is to do what is done now – levy indirect taxes and compensate low income groups through direct transfers.

In any case, Saunders' proposals for income tax cuts could even not compensate many middle income families for the withdrawal of public support for education and health care. According to Treasury estimates, nearly 40% of Australian families currently receive more in family benefits than they pay in taxes and the effective tax break-even point for a single income couple with two children is around \$45,000 a year (Bremner, 2005). The additional amounts required to cover private health insurance costs and education expenses would imply even higher effective tax thresholds, unless what is envisaged is a significant redistribution away from families with children to those currently without children. Alternatively families could be given vouchers to pay for education and health insurance costs, or a combination of vouchers and tax cuts, but vouchers still require tax revenues.

The transition problems involved in moving to such a privatised welfare system would be formidable. As the discussion above suggests, a good deal of lifecycle redistribution in the Australian welfare state is from the young to the old and from those currently without children (but who will have children or whose children have already grown up) to those with children. If a new system were introduced within a short time-frame, those whose children have grown up and recently left home would be significant winners, even though on average they are among the best-off households and have already benefited from substantial transfers. One might envisage a very long phase-in arrangement, where younger households build up private savings accounts while still paying for the pensions and health care costs of the elderly, but most people would experience this as a reduction in disposable income, because they would have the double burden of self-provision while still protecting those who are too old or too poor to make such self-provision. A heavy double burden is unavoidable in any transition to a privatised welfare state, unless current protection for the old and the poor is curtailed.

Perhaps most significantly, it is not clear that such a system would necessarily solve the incentive problems it is supposed partly to address. Saunders (2005b) appears to envisage moving to a system

where most people self-provide through significant contributions to personal accounts as in Singapore (a total of 40% of earnings), combined with a much more targeted welfare system for the lifetime poor, perhaps involving government contributions to personal accounts or direct cash transfers as is currently the case. A more targeted system – presumably with 100% withdrawal rates – concentrates higher effective marginal tax rates on a smaller group of the population, perhaps strengthening disincentives for this group to work and save, but also with potential spill-over effects in terms of disincentives for those not far over the benefit cut-out point.

This discussion should not be taken to imply that it is not important to assess whether specific transfer policies and taxation policies are efficient or could not be improved. Undoubtedly, it would be possible to improve the efficiency and effectiveness of the tax-transfer system. The point of the discussion is that the apparent level of “churning” by itself is a very limited measure of the scope for reform. Such an assessment needs to be based on a detailed assessment of individual programmes, not broad and potentially misleading statistical measures.

### **3. BENEFIT RECEIPT IN OECD COUNTRIES**<sup>23</sup>

Does Australia have relatively few people receiving welfare payments (ACOSS, 2004) or has it too many (Saunders, 2004)? The proportion of the working age population receiving benefits in Australia increased from 13% in 1980 to 17.5% in 1999, while on average for the 16 countries shown benefit receipt went from 14.2 to 19.7% (Table 5). As pointed out by ACOSS (2004), in 1999 Australia had the fifth lowest level of benefit receipt, exceeding only Japan, New Zealand, Spain and the United States. However, the degree of variability in benefit receipt is much lower than in spending, for example, and the average is pushed up by the extremely high level of receipt in the Slovak Republic; excluding the Slovak Republic the average would drop to 18.5% of the working-age population, so a more accurate characterisation would be that Australia is slightly below the average rather than being very low.<sup>24</sup>

In Australia, benefit receipt was around 35% higher at the end of the period, with a significant group of countries experiencing broadly similar trends, with recipiency increasing in Austria, Belgium, Canada, Germany, Japan and Spain by between 30 and 45%. Benefit recipiency increased more markedly in France (75%) and the Slovak Republic (95%), but most significantly in New Zealand, where it increased two and a half times. In other countries such as Denmark, the Netherlands and Sweden the increase in benefit receipt was between 10 and 25%, while only in the United States did rates of receipt fall – by around 17% overall, which is mainly explained by the halving of receipt of lone parents and social assistance benefits, presumably as a consequence of welfare reform in the second half of the 1990s. In many countries, the increase in rates of benefit receipt over this period appears mainly due to an increase in receipt of early retirement payments, although disability, unemployment and lone parents/social assistance were also important contributors to growth.

How is Australia different from other OECD countries? Unsurprisingly, most of the differences in levels of benefit receipt can be explained by the fact that Australia does not have a contributory social insurance system, while most other countries do. The largest difference is due to greater access to insurance-based payments, such as early retirement pensions in many other OECD countries, where Australia is around half the average of these countries, plus use of survivors' pensions. The absence of statutory maternity leave in Australia is also a significant factor, although this is a different type of social risk since it does not necessarily imply long-term disadvantage (although there may be some overlap with lone parenthood).

In contrast, receipt of income-tested payments (unemployment, lone parents and non-categorical social assistance benefits) is higher in Australia than many other countries (apart from New Zealand), by around 1% of the population of working age in the case of unemployment benefits and 0.5% for lone parents and social assistance (relative to the average). Separate analysis (OECD 2005) finds that Australia, along with the United Kingdom, Ireland and New Zealand has very high rates of receipt of benefits among the lone parent population, and the lowest levels of employment for lone parents in the OECD. As discussed below, this is likely to be because in these English-speaking countries, the

conditions of eligibility for support for lone parents are among the most generous in the OECD.

In the case of unemployment benefit recipients, Australia is one of a number of countries – along with Belgium, Canada, Denmark, Germany, Ireland, the Netherlands and New Zealand – where the number of recipients of unemployment payments exceeds the number of unemployed in labour force surveys. In Australia the number of benefit recipients in 1999 was around 19% higher than the number of unemployed, although in Ireland there were close to twice as many recipients as unemployed. In contrast, in Japan, the Slovak Republic and the United States only between 30 and 40% of the unemployed were receiving benefits. In the case of Japan and the United States (and also Spain) this appears to be the result of coverage gaps – significant numbers among the unemployed either do not satisfy contribution requirements or have exhausted their entitlements. In contrast, in the Slovak Republic many unemployed appear to be receiving early retirement payments or social assistance.

The question of whether benefit recipiency numbers are too high or too low can only be answered by reference to broader concerns. To the extent that benefit receipt is the result of labour market problems and/or benefit dependency induced by the welfare state, then almost any level of receipt is an important social problem requiring reform, with the aim of reducing recipiency rates as far as possible (although zero is unlikely to be feasible). But to the extent that low rates of receipt are the result of gaps in coverage of social risks, then higher benefit recipiency could actually be associated with better social outcomes. The optimum result, however, is to have comprehensive social protection, but to reduce the need for people to use it.

Aggregate indicators such as those in Table 5 do not allow us to distinguish between such alternatives, although the last two rows of Table 5 provide some indirect evidence. The poverty rate refers to the proportion of persons living in households with a working-age head and with incomes below 50% of the median, and the not working rate is the proportion of all people (including children) living in households with a working-age head and with no one in paid employment . With the exception of Japan and the US, all countries have poverty rates that are significantly below their benefit recipiency

rates (although in Spain they are nearly identical). That is, higher rates of benefit reciprocity are not necessarily associated with higher income poverty; in fact, low rates of benefit reciprocity in the US are accompanied by high poverty, while higher rates of reciprocity, for example, in France, Belgium and Denmark are accompanied by relatively low poverty rates. In Australia, both benefit reciprocity and working-age poverty are close to “average”.

This should not be a cause for complacency, however. The data on the not-working rate show that after Germany, and at the same level as the United Kingdom, Australia has the highest level of households in which no-one is working, while Japan and the United States have the lowest levels. Interpreting these patterns is complicated by differences in household composition across countries,<sup>25</sup> and it is also difficult to say which way causality runs, but one view could be that low levels of benefit receipt are associated with lower levels of worklessness among people of working age. But low levels of benefit receipt are not associated with lower rates of poverty, at least in part because of coverage gaps. Perhaps more significantly, work is much more effective at shielding households from poverty in Australia than in almost any other country: the poverty rate for working-age households with one worker in Australia is the second lowest in the OECD after Norway (respectively, 5.7 and 3.2%), while in the US work is far less effective, with 26.5% of households with one earner being below the poverty line (Förster and Mira D'Ercole, 2005).

#### **4. BENEFIT LEVELS - ARE BENEFITS FOR THE POOR, POOR BENEFITS?**

In characterising Australia’s social security system as “lean and mean”, ACOSS (2204) argued that Australian benefits are lower on average than in most other OECD countries, particularly in comparison with wages. In Section Two of this article, however, it was argued that net redistribution to the poor in Australia was probably the highest among OECD countries. How can these views be reconciled?

As with other parts of the welfare state debate, a good deal depends on how things are measured. An

initial observation is that in an earnings-related transfer system poor people get less than the average benefit (because benefits increase with higher previous earnings), while in an income-tested system poor people get more than the average benefit (because benefits fall with any additional income). So comparing average benefits across systems does not tell us who is more generous to the poor.

ACOSS uses OECD estimates of net replacement rates – how the disposable incomes of beneficiaries compare with the incomes after taxes of the “average production worker” (APW) (OECD, 2004). As a starting point, it is important to note that because Australia and New Zealand rely on income-tested flat-rate entitlements rather than earnings-related benefits, it is undoubtedly true that for higher income earners, Australian benefits are ungenerous. For example, to take the 2004 case of a 40 year old single worker who has contributed to unemployment insurance for 22 years: in France, such a worker on becoming unemployed would receive between 57% and 75% of their gross earnings for up to 30 months, with a maximum benefit payable of nearly 65,000 Euros (about 3 times the average wage)<sup>26</sup>; in Germany, a similar person could receive 60% of net earnings for 12 months up to a maximum of 103% of the average wage; in addition, in Japan, Luxembourg, the Netherlands, Norway, Portugal and Switzerland the maximum unemployment insurance benefit payable would be higher than average earnings; in Sweden the maximum is about three-quarters of average earnings, while in other countries with unemployment insurance, figures of 40 to 50% of average earnings are common maxima (OECD, 2004).

When insurance benefits are exhausted – most commonly after 6 to 12 months (but as high as 36 months in Norway, 48 months in Denmark, and 60 months in Iceland) an unemployed person may become eligible for unemployment assistance, which is similar in structure to unemployment benefits in Australia and New Zealand. In addition to Australia, New Zealand and the United Kingdom, 10 OECD countries have unemployment assistance schemes (OECD, 2004). These benefits are commonly flat-rate and range between 20 and 40% of the APW wage, although in Austria and Germany they can be as high as 51 and 87% of the APW wage, respectively. Other countries without unemployment assistance rely on general social assistance schemes.

Over time, there also appears to have been an increasing role played by unemployment assistance schemes relative to unemployment insurance in many OECD countries with mixed systems. In 2000, between 40 and 50% of unemployment beneficiaries in Austria, Germany, the Netherlands and Portugal were receiving assistance benefits rather than insurance benefits, although the ratio ranged from 22% in France to 80% in the United Kingdom (Vroman and Brusentsev, 2005).

While benefits for middle and higher income groups (and for the unemployed spouses of workers) are thus much lower in Australia than in many countries, the situation for low paid workers and those without contribution histories is more mixed. For example, only 11 OECD countries provide unemployment benefits for youth who do not have contribution histories, with six of these probably being more generous than Australia. In addition, as the unemployed are much more likely to have been low wage rather than average wage workers when they had jobs, it is also important to compare minimum insurance benefits.

Moreover, for families with children other measures of benefit generosity suggest a very different picture. Part of the explanation for low replacement rates in Australia is that Australian wages appear to be among the highest in the OECD (OECD, 2004). This reflects the absence of substantial employer social security contributions in Australia (apart from the Superannuation Guarantee). These contributions appear to be largely incident on wages – that is employers pay contributions to the government and reduce wage levels accordingly. For example, an average manufacturing worker in Australia earns about 50 per cent more than a similar worker in France or Sweden and 45 per cent more than in Austria or Italy, when gross earnings are adjusted by Purchasing Power Parities (PPPs) to a common currency. In these countries, however, employers are paying social security contributions of up to 40 per cent of gross wages, so that total employer labour costs are about 16% below those in Australia.

Table 6 shows three alternative measures of benefit levels for social assistance recipients with children

– benefits expressed as a percentage of the net average production worker’s wage, adjusted by PPPS to US dollars, and expressed as a percentage of GDP per capita. Given the difficulty in comparing wage levels as a result of differing levels of employer social security contributions, it can be argued that either PPP-adjusted benefit levels or benefits as a percentage of GDP per capita are likely to provide more consistent international measures. On balance, the best measure is likely to be taking benefits as a % of GDP per capita, given that part of the reason why PPP-adjusted measures vary across countries is that countries vary in their level of national income.

Table 6 shows that for lone parents with two children, benefit entitlements as a per cent of the APW wage in Australia are around the OECD average, and exceeded by 17 countries. Adjusted by PPPS, Australian benefits are nearly 40% above the average and exceeded by six countries. As a percentage of GDP per capita, Australian benefits for lone parents are about 30% above the OECD average, and also exceeded by six countries. For unemployed couples with children, benefits are slightly more generous with Australia ranked equal fifth on the GDP per capita measure.

Thus, as a % of GDP per capita, benefits for the poor with children in Australia are well above average, and this is also true in the United Kingdom and New Zealand, and in Denmark, Germany, Switzerland, Korea and Japan (for lone parents). Having said this, in Switzerland, Korea and Japan very few families with children are receiving social assistance, both because there are lower levels of need for assistance and also because benefit levels are theoretically generous but eligibility conditions are very restrictive.

It is essential to note, however, that the fact that Australian benefits for poor families are generous compared to many other countries does not in itself mean that benefit levels are adequate, or that there is not a case for increasing them. Adequacy of benefits can only be defined by reference to the living standards that Australian benefits afford in Australia, and political and social judgements about what is an acceptable living standard for Australians. The fact that benefits for the Australian poor are higher than benefits for the Italian poor does not help anyone in Australia pay the rent or any other

bills. But it does mean that it isn't valid to argue for increasing benefits in Australia because Australia spends less on welfare than Italy and many other countries.

Are Australian benefits subject to stringent income and assets tests? This is certainly true if one makes a comparison with social insurance benefits, which are not income or assets-tested. However, social assistance schemes in most other countries are considerably more stringent than in Australia or New Zealand. In virtually all other OECD countries, the benefit withdrawal rate in social assistance schemes is 100% (apart from Canada); only 13 OECD countries have income disregards or free areas in assistance schemes, and in most of these this is only for earnings and in some cases only for limited periods (OECD, 2004). Indeed, Table 6 shows average effective tax rates for social assistance recipients with children in 2003; these are similar to effective marginal tax rates, except calculated over wider and more realistic ranges of earnings. In the case of Table 6, these show how much would be lost through benefit withdrawal and through direct taxes for lone parents and couples with two children if they earned either one-third, half, or two-thirds of the APW wage (corresponding to part-time work and low-paid full-time work). Greece and Italy have very low AETRS, because the benefits that are being withdrawn are practically non-existent; the United States also has low AETRS reflecting its low benefit levels. In Australia, New Zealand and Canada, while AETRS are as high as or higher than the top marginal rate in the income tax system, the AETRS are lower than all remaining OECD countries, even though their replacement rates are around average. This is a consequence of lower benefit withdrawal rates.

Assets tests are also generally much more generous in Australia than in other OECD countries apart from New Zealand. Australia also has a centralised benefit system with legislated rights of appeal, while many other countries have decentralised systems with significant discretionary elements. In addition, in countries, such as Austria, France, Luxembourg, Germany and Switzerland, social assistance benefits are claimable from relatives or there may be obligations to repay benefits either after employment is found or on the death of the recipient (Eardley *et. al*, 1995).

Overall, access to income-tested benefits is actually much easier in the English-speaking countries (apart from the US, and to some extent Canada), than in the Nordic or other European welfare states, or Japan and Korea. This probably reflects the absence of a contributory social insurance system, since the benefit systems in Australia and New Zealand, and to a lesser extent in the United Kingdom and Ireland, are performing some of the social protection functions that in other countries are performed by insurance systems. In Scandinavia and continental Europe, social assistance is residual, but not in Australia or New Zealand.

## **CONCLUSIONS**

Nearly 25 years after Fred Gruen's 1982 debunking of myths of the welfare state, many of the same arguments are still being made. The main points made in this article are as follows:

- Australian social expenditure levels are below the OECD average, by around 20% using an unweighted average for the OECD, and around 5% if spending on a weighted basis.
- Social spending appears to have increased in Australia relative to OECD average, but a good deal of this is due to data improvements – spending was always higher than it has been measured in the past.
- Differences in levels of social spending in Australia are mainly due to spending on the aged, not spending on people of working age.
- The OECD countries with the highest gross social spending claw back a lot of this through direct and indirect taxes. Differences in net social expenditure are much less than differences in gross spending.
- Even though Australia spends less than the OECD average on social security benefits, the formula for distributing benefits is so progressive – and the level of taxes paid by the poor is so low – that Australia appears to redistribute more to the poorest 20% of the population than any other OECD country.
- Churning is less of an issue than in other OECD countries, but measurement issues suggest

that this concept is of limited usefulness. In any case, reform proposals should be specific rather than based on broad statistical measures.

- Benefit receipt among people of working age is a little lower than the OECD average, but mainly due to lower early retirement and absence of statutory maternity and parental leaves. Receipt of unemployment benefits and benefits by lone parents is above the OECD average.
- For low income groups, the Australian system is among the relatively most generous in the OECD, but this is not true for middle and higher income groups.
- Generosity also needs to be measured in relation to ease of access to benefits and not just benefit levels.
- Relative generosity is not necessarily the same as adequacy.

It is worth noting that many of these conclusions are precisely what could be predicted from the design features of the Australian social security system; that is, in a system of flat rate, income tested benefits, financed from general government revenue rather than contributions, it should be expected that a higher proportion of benefits will reach low income groups rather than the rich, and that consequently benefits for the poor will be relatively generous. Correspondingly, it is hardly surprising that Australian benefit recipients are less likely to belong to groups who in other countries receive insurance benefits. Some of the arguments in this article may be less expected, however. The evidence presented suggests that Australia and the United Kingdom, and to some extent New Zealand, are among the most generous welfare states to the poor among OECD countries, and in this respect at least are more like Denmark, Finland and the Netherlands than the United States.

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**Table 1: Trends in Spending On Social Welfare, OECD Countries, 1980 to 2001**

% of GDP

	Trends in spending			Components of spending, 2001								
	1980	2001	Change	Age	Survivors	Disability	Health	Family	ALMP	Unemployment	Housing	Other
Australia	11.3	18.0	6.7	4.7	0.2	2.3	6.2	2.8	0.4	1.0	0.1	0.1
Austria	22.5	26.0	3.5	10.7	2.7	2.5	5.2	2.9	0.5	0.8	0.1	0.5
Belgium	24.1	27.2	3.1	8.7	2.6	3.3	6.4	2.3	1.3	2.2	a	0.4
Canada	14.3	17.8	3.5	4.8	0.4	0.8	6.7	0.9	0.4	0.8	0.5	2.4
Czech Republic	m	20.1	..	6.7	0.9	3.0	6.7	1.6	0.2	0.2	0.1	0.6
Denmark	29.1	29.2	0.2	8.3	0.0	3.9	7.1	3.8	1.5	3.0	0.7	1.1
Finland	18.5	24.8	6.3	7.9	1.0	3.9	5.3	3.0	0.9	2.0	0.3	0.5
France	21.1	28.5	7.3	10.6	1.5	2.1	7.2	2.8	1.3	1.6	0.9	0.4
Germany	23.0	27.4	4.4	11.7	0.4	2.3	8.0	1.9	1.1	1.2	0.2	0.5
Greece	11.5	24.3	12.9	12.7	0.9	1.8	5.2	1.8	0.2	0.4	0.7	0.6
Hungary	m	20.1	..	8.0	0.3	2.7	5.1	2.5	0.5	0.4	0.5	0.2
Iceland	m	19.8	..	5.5	0.6	2.8	7.5	2.6	0.1	0.2	0.1	0.4
Ireland	17.0	13.8	-3.2	2.7	0.8	1.4	4.9	1.6	0.7	0.7	0.5	0.5
Italy	18.4	24.4	6.0	11.3	2.6	2.1	6.3	1.0	0.5	0.6	0.0	0.0
Japan	10.2	16.9	6.7	7.3	1.2	0.7	6.3	0.6	0.3	0.5	a	0.2
Korea	m	6.1	..	1.2	0.2	0.5	3.2	0.1	0.3	0.2	a	0.5
Luxembourg	23.5	20.8	-2.7	7.5	0.6	3.6	4.8	3.4	0.1	0.5	0.1	0.2
Mexico	m	11.8	..	7.4	0.2	0.2	2.7	0.3	0.1	a	0.8	0.2
Netherlands	26.9	21.8	-5.2	6.4	0.7	4.1	5.7	1.1	1.5	1.3	0.4	0.6
New Zealand	17.2	18.5	1.3	4.7	0.1	2.8	6.1	2.2	0.5	1.1	0.8	0.1
Norway	17.9	23.9	6.0	6.8	0.3	4.8	6.8	3.2	0.8	0.4	0.2	0.6
Poland	m	23.0	..	8.5	2.1	5.5	4.4	0.9	0.1	1.0	0.2	0.2
Portugal	10.9	21.1	10.2	7.9	1.5	2.5	6.3	1.2	0.6	0.9	0.0	0.3
Slovak Republic	m	17.9	..	6.7	0.2	2.3	5.0	1.5	0.4	0.5	0.1	1.2
Spain	15.9	19.6	3.7	8.3	0.6	2.4	5.4	0.5	0.8	1.3	0.2	0.1

Sweden	28.8	28.9	0.1	9.2	0.6	5.2	7.4	2.9	1.4	1.0	0.6	0.6
Switzerland	14.2	26.4	12.2	11.8	1.6	3.8	6.4	1.2	0.5	0.5	0.1	0.6
Turkey **	4.3	13.2	8.9	5.1	1.2	0.4	3.9	1.1	0.1	0.9	0.0	0.5
United Kingdom	17.9	21.8	3.9	8.1	0.6	2.5	6.1	2.2	0.3	0.3	1.5	0.2
United States	13.3	14.8	1.5	5.3	0.8	1.1	6.2	0.4	0.2	0.3	a	0.5
OECD-21 *	17.7	21.9	4.2	7.9	1.0	2.5	6.1	1.9	0.7	1.1	0.4	0.5
OECD-30 *	m	20.9	..	7.6	0.9	2.6	5.9	1.8	0.6	0.9	0.4	0.5
Australia/OECD21	0.64	0.82	1.59	0.60	0.26	0.91	1.02	1.54	0.64	0.93	0.28	0.25
Difference	6.4	3.9	(2.5)	3.2	0.8	0.2	(0.1)	(0.9)	0.3	0.1	0.3	0.4

\* 1999 data for Turkey for 2000 and 2001 OECD averages. OECD averages exclude countries where data are not available for related time series: OECD-21 exclude Austria, Czech Republic, Hungary, Iceland, Korea, Mexico, Norway, Poland and Slovak Republic.

Source: OECD (2004), Social Expenditure Database (SOCX, [www.oecd.org/els/social/expenditure](http://www.oecd.org/els/social/expenditure)).

**Table 2: Distribution of incomes and progressivity of transfers and taxes, OECD Countries, 2000**

	Gini coefficient						Quintile ratio
	Private income	<i>Income and taxes</i>		Total Transfers	<i>Cash Transfers</i>		Total
		Disposable income	Direct Taxes		Pensioners	Working Age	
Australia	47.1	30.5	54.5	-38.3	-6.1	-42.4	12.69
Austria	(25.2)	22.5	..	-6.0	17.3	-1.6	0.69
Belgium*	52.7	27.2	51.6	-7.4	22.2	-9.5	1.30
Canada	42.0	30.1	44.6	-12.0	-0.6	-11.2	1.70
Czech Republic	47.2	26.0	48.1	-18.9	3.7	-18.6	2.75
Denmark	40.8	22.5	34.8	-29.2	-5.6	-28.1	4.33
Finland	38.6	26.1	41.9	-23.0	-11.9	-27.2	3.33
France	48.7	27.3	44.9	-3.0	23.9	-7.1	0.83
Germany	47.7	34.5	42.2	-1.3	18.0	-6.5	0.96
Greece	46.6	34.5	..	17.2	23.6	21.8	0.41
Hungary	(46.3)	29.3	..	-6.0	9.2	-6.4	1.30
Ireland	43.4	30.4	49.4	-22.6	2.9	-24.1	3.07
Italy	51.8	34.7	47.4	14.8	20.7	19.6	0.43
Japan	41.0	31.4	31.9	3.2	11.0	3.3	0.77
Luxembourg	(42.1)	26.1	..	-8.2	12.5	-3.4	0.99
Mexico	(49.8)	48.0	..	37.1	44.6	43.8	0.20
Netherlands	36.7	25.1	37.1	-22.1	-0.9	-26.3	3.07
New Zealand	48.3	33.7	52.2	-30.7	-0.1	-37.1	5.12
Norway	41.3	26.1	38.8	-20.6	6.9	-18.3	2.87
Poland	(54.3)	36.7	..	5.9	10.6	4.5	0.74
Portugal	47.9	35.6	50.8	15.1	28.5	18.4	0.53
Spain	(35.4)	32.9	..	5.4	13.0	8.4	0.75
Sweden	44.6	24.3	36.0	-14.3	12.5	-15.2	2.00
Switzerland	37.6	26.7	22.8	5.9	19.2	-5.0	0.35
Turkey	..	43.9	..	21.3	21.5	21.3	0.28
United Kingdom	48.5	32.6	50.8	-28.6	2.6	-35.4	4.81
United States	45.0	35.7	57.3	-8.8	11.5	-12.6	1.41
OECD-27	44.3	30.9	44.1	-6.5	12.0	-7.2	2.14

Notes: Figures for Belgium refer to 1995. Bracketed figures are incomes before transfers, but after taxes.

Source: Calculated from various waves of OECD Income Distribution Study.

**Table 3: Distribution of transfers, OECD countries, around 2000**

	Transfers as % of Household Disposable Income (HDI)	Share of lowest quintile (%)	Transfers to lowest quintile as % of HDI	Taxes as % of HDI	Share of lowest quintile	Taxes paid by lowest quintile as % of HDI	Net transfers to lowest quintile	Indirect tax rate
Australia	15.1	40.6	6.13	24.8	0.4	0.10	6.03	9.9
Austria	16.3	15.5	2.53	..	..	..	..	16.2
Belgium	31.4	20.3	6.37	37.3	1	0.37	6.00	14.4
Canada	14.7	26.3	3.87	28.8	3.6	1.04	2.83	11.2
Czech Republic	23.9	25.1	6.00	19.6	3.1	0.61	5.39	16
Denmark	25.5	35.9	9.15	53.3	6	3.20	5.96	26.5
Finland	15.6	32.6	5.09	32.6	4	1.30	3.78	21.4
France	30.1	19.6	5.90	9.2	7.7	0.71	5.19	15.9
Germany	26.9	20.2	5.43	38.3	3	1.15	4.28	13.7
Greece	21.7	12.6	2.73	..	..	..	..	..
Hungary	33.7	19.8	6.67	..	..	..	..	..
Ireland	14.9	33.5	4.99	17.3	1.2	0.21	4.78	19.9
Italy	28.0	11.7	3.28	28.9	2.7	0.78	2.50	13.1
Japan	17.0	15.7	2.67	18.2	7.4	1.35	1.32	6.5
Luxembourg	24.6	18.0	4.43	..	..	..	..	..
Mexico	5.6	11.0	0.62	..	..	..	..	7.7
Netherlands	19.0	32.5	6.18	34.5	5.2	1.79	4.38	17.4
New Zealand	13.6	33.3	4.53	27.7	0.7	0.19	4.33	15.6
Norway	20.6	30.7	6.32	34.2	4.3	1.47	4.85	23.0
Poland	26.0	14.0	3.64	..	..	..	..	..
Portugal	19.5	16.8	3.28	17.2	3.5	0.60	2.67	..
Spain	21.0	16.0	3.36	..	..	..	..	13.0
Sweden	32.2	25.8	8.31	46.3	5.5	2.55	5.76	20.7
Switzerland	20.8	20.8	4.33	34	12.6	4.28	0.04	..
Turkey	1.9	8.5	0.16	..	..	..	..	..
United Kingdom	16.8	33.7	5.66	21.5	1.8	0.39	5.27	13.5
United States	7.4	25.5	1.89	32.1	1.4	0.45	1.44	4.4
Average	20.1	22.8	4.6	29.3	4.0	1.2	4.0	15.0

Source: Calculated from OECD Income Distribution study.

**Table 4: Churning as % of disposable income and direct taxes, around 2000**

	Disposable Income	Direct Taxes	Ratio (%) of transfers to taxes
Australia	5.6	22.7	60.6
Austria	..	..	..
Belgium	18.0	48.1	84.1
Canada	13.0	44.4	61.5
Czech Republic	10.3	52.7	122.0
Denmark	18.0	70.7	47.8
Finland	11.1	34.0	47.7
France	9.2	100.0	327.9
Germany	20.4	53.3	70.2
Greece	..	..	..
Hungary	..	..	..
Ireland	7.5	43.8	86.2
Italy	21.1	73.0	96.8
Japan	9.9	51.0	52.4
Luxembourg	..	..	..
Mexico	..	..	..
Netherlands	13.4	39.0	55.1
New Zealand	7.5	27.1	49.3
Norway	14.2	41.5	60.3
Poland	..	..	..
Portugal	13.5	78.0	112.8
Spain	..	..	..
Sweden	23.6	51.0	69.7
Switzerland	20.2	59.5	61.2
Turkey	..	..	..
United Kingdom	12.0	56.0	78.3
United States	12.7	39.7	28.5
Average	13.7	51.9	82.8

Notes: 1. Churning is calculated by comparing the level of transfers received by each decile with the level of direct taxes (income taxes and employee social security contributions) paid by each decile. Where transfers exceed taxes, then churning is the level of taxes, and where taxes exceed transfers, churning is the level of transfers. The results are then expressed as a percentage of household disposable income and also as a percentage of direct taxes. 2. The ratio of transfers to taxes is the sum of all transfers to households as a percentage of direct taxes paid by households.

..: Taxation data not available.

Source: Calculated from OECD Income Distribution Study, 2005.

**Table 5: Benefit receipt among people of working age, OECD countries, 1980 and 1999**

% of working age population

		Australia	Austria	Belgium	Canada	Denmark	France	Germany	Ireland	Japan	Netherlands	New Zealand	Slovak Rep.	Spain	Sweden	UK	US	Mean
Old age	1980	1.8	3.3	4.0	0.6	1.2	2.2	2.7	0.0	3.5	0.0	1.3	5.7	0.4	1.8	3.4	1.8	2.1
	1999	1.9	7.4	7.2	3.1	4.0	7.0	4.6	0.5	5.1	0.8	1.4	9.4	1.1	0.4	3.4	1.8	3.7
Survivors	1980	0.8	3.0	1.6	1.3	0.5	0.5	1.6	1.5	0.8	1.8	0.8	1.8	1.6	1.5	1.6	1.3	1.4
	1999	0.3	2.1	1.1	1.7	0.0	0.3	1.7	1.4	1.6	1.0	0.4	1.1	1.8	0.3	0.9	0.6	1.0
Sickness	1980	1.0	2.4	1.4	0.1	4.3	2.4	2.7	3.4	2.2	3.3	0.5	3.3	0.3	4.8	1.2	1.9	2.2
	1999	1.4	2.0	1.1	0.2	4.6	1.8	2.5	1.9	1.2	3.4	1.5	3.1	0.4	5.8	0.8	2.1	2.1
Disability	1980	4.2	4.1	3.0	3.4	5.7	5.0	5.2	1.6	1.0	6.9	1.1	4.3	3.0	5.1	2.7	5.5	3.9
	1999	4.9	3.5	3.6	4.9	6.7	4.8	4.1	3.9	1.9	7.2	2.3	5.6	3.9	6.5	6.4	6.3	4.8
Maternity and Parental	1980	0.0	1.2	0.1	0.2	0.4	0.5	0.2	0.2	0.1	0.0	0.0	3.6	0.0	1.5	0.3	0.0	0.5
	1999	0.0	2.0	0.2	0.4	1.6	1.9	0.2	0.2	0.2	0.0	0.0	4.4	0.0	2.0	0.3	0.0	0.8
Care & Leave	1980	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
	1999	0.3	0.0	0.9	0.0	0.0	0.0	0.0	0.5	0.0	0.0	0.0	0.0	0.0	0.0	1.0	0.0	0.2
Unemployment	1980	3.2	0.9	5.4	6.0	5.2	3.1	2.0	4.5	0.8	2.9	1.1	0.0	2.8	1.1	4.7	2.5	2.9
	1999	5.6	3.8	6.9	5.8	4.4	4.7	6.6	6.7	1.1	4.1	6.6	3.6	3.9	4.0	2.9	1.2	4.5
Lone Parents / social assistance	1980	2.0	0.6	1.5	1.7	2.5	0.2	0.9	1.0	0.5	1.2	1.9	0.7	0.0	0.2	1.0	3.4	1.2
	1999	3.2	0.8	2.4	1.9	1.6	3.0	2.2	4.2	0.3	1.2	4.4	11.1	0.3	1.1	2.8	1.7	2.6
Total	1980	13.0	15.5	17.0	13.4	19.9	13.8	15.2	12.4	8.8	16.1	6.5	19.6	8.1	16.1	15.0	16.5	14.2
	1999	17.5	21.6	23.4	18.0	22.9	23.6	22.0	19.3	11.4	17.7	16.6	38.2	11.3	20.1	18.4	13.7	19.7
Poverty rate	2000	9.4	9.4	6.6	10.9	4.1	6.4	8.6	13.3	13.2	6.8	11.8	..	11.2	4.7	10.9	15.9	9.5
Not working *	2000	13.5	9.4	13.0	5.5	8.7	11.1	16.2	9.6	2.8	11.3	9.6	..	8.0	6.1	13.5	4.9	9.5

Note: The poverty rate is the proportion of people in households headed by a person of working age with equivalent disposable incomes less than 50% of the median. The not working rate is the percentage of all people (including children) living in households with a working age head where no one is in paid employment.

Source: OECD, 2003, 2005.

**Table 6: Parameters of social assistance schemes, OECD countries, 2003**

	Lone parent			One-earner couple			Lone parent	One-earner couple	Lone parent	One-earner couple	Lone parent	One-earner couple
	<u>Minimum income</u>						<u>Average Effective Tax Rate (%)</u>					
	USD PPPs	% APW	% GDP pc	USD PPPs	% APW	% GDP pc	0-33% APW	0-50% APW	0-67% APW	0-33% APW	0-50% APW	0-67% APW
Australia	17150	48	61	20180	57	72	47	68	51	70	57	77
Austria	14650	58	50	17680	70	61	100	100	98	100	81	99
Belgium	14140	42	51	14140	42	51	106	106	83	77	73	71
Canada	15850	49	52	16780	51	55	54	57	62	65	57	63
Czech Republic	7120	51	47	9000	65	60	100	100	89	100	77	91
Denmark	18810	53	64	21260	60	73	99	69	101	79	92	90
Finland	14730	54	56	17910	65	68	69	87	64	91	65	94
France	13020	54	48	14330	60	53	63	62	75	75	81	82
Germany	15790	47	61	16850	51	65	84	84	82	82	85	76
Greece	400	2	2	400	3	2	16	16	16	16	16	16
Hungary	2610	29	19	2470	27	18	60	60	44	44	38	38
Iceland	15850	59	56	21020	78	74	95	104	79	104	70	89
Ireland	14530	58	44	19350	77	59	53	100	45	96	21	88
Italy	440	2	2	590	2	2	0	-4	0	-4	-3	-8
Japan	18430	63	68	11700	40	43	79	79	84	84	91	86
Korea	11410	37	67	14200	46	84	100	100	76	90	60	73
Luxembourg	19120	62	39	24470	80	50	73	57	86	75	82	84
Netherlands	16660	52	57	15960	50	55	94	96	81	92	79	88
New Zealand	13570	50	62	14590	53	67	55	69	60	70	69	77
Norway	17190	56	48	15230	52	43	89	100	83	100	78	87
Poland	5350	38	49	7230	52	67	100	100	82	100	81	87
Portugal	5830	47	32	8280	67	45	55	55	56	55	56	55
Slovak Republic	5410	65	44	7400	90	60	100	100	100	100	90	100
Spain	7200	34	32	7900	37	35	98	106	67	73	57	62

Sweden	12580	51	46	15200	62	56	81	100	63	100	61	100
Switzerland	19960	59	66	21959	65	72	100	100	100	100	91	99
United Kingdom	17940	58	64	20500	66	73	81	89	47	67	58	73
United States	9780	30	27	11800	37	33	34	36	39	43	43	46
OECD	12340	47	47	13871	54	53	74	78	68	77	65	74

1. Results relate to the situation of a person who receives no unemployment insurance benefits but is entitled to income-related benefits, such as social assistance, as applicable. Hourly earnings following the transition into work correspond to the APW level throughout so that a person making a transition into a half-time job would have total earnings equal to 50% of APW. Any income taxes payable on unemployment benefits are determined in relation to annualised benefit values (i.e. monthly values multiplied by 12) even if the maximum benefit duration is shorter than 12 months. Given the transition into employment, in-work benefits that depend on the transition are available. Children are aged 4 and 6 and neither childcare benefits nor childcare costs are considered. For married couples the percentage of APW relates to one spouse only; the second spouse is assumed to be inactive with no earnings in a one-earner couple. Source: OECD, Tax-Benefit Models.

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<sup>1</sup> This analysis draws very heavily on the work of colleagues at the OECD, particularly Willem Adema, Michael Förster, David Grubb, Herwig Immervoll, Maxime Ladaïque, Marco Mira D'Ercole and Mark Pearson. However, the interpretations of their analysis are my own, and I am responsible for any errors.

<sup>2</sup> This refers to total public spending, not just spending on the welfare state. Overall, social expenditures account for between 40 and 55% of total government spending in most OECD countries, and 48% in Australia.

<sup>3</sup> OECD data on welfare state spending includes public health expenditures, social security transfers (e.g. pensions, benefits and family assistance) and welfare services (e.g. child care, homes for the aged and people with disabilities, active labour market programmes), but not education spending. The data on the distribution of benefits and the number of benefit recipients only cover social security transfers, and not welfare services. The discussion that follows also largely ignores the impact of the health system, except in relation to spending.

<sup>4</sup> Data on social spending is available in OECD (1976, 1985, 1996) and Varley (1986). The most recent edition of this database was published in 2005 on the OECD website, with data up to 2001. See [http://www.oecd.org/document/2/0,2340,en\\_2649\\_33933\\_31612994\\_1\\_1\\_1\\_1,00.html](http://www.oecd.org/document/2/0,2340,en_2649_33933_31612994_1_1_1_1,00.html)

<sup>5</sup> A further factor is differences in household composition across countries.

<sup>6</sup> Following OECD conventions, this paper uses the unweighted average for OECD countries. It could be argued that it would be more appropriate to use the weighted average; weighted by GDP the OECD average level of social expenditure in 2001 was 18.7% rather than 21.2% of OECD-21 GDP, so that on this measure Australia was around 96% of the OECD average in 2001. The main reason for this difference is that the two largest OECD economies – the United States and Japan – spend less than the OECD unweighted average and less than Australia. However, as discussed below, on other measures of net public and private welfare spending the United States actually spends more than Australia.

<sup>7</sup> Australia also spends nearly 4 times the OECD average on benefits for lone parents, but Australia is one of only 10 OECD countries that are able to separately identify spending on lone parents, because in most other countries spending on lone parents is provided through non-categorical social assistance programs. Thus Australia appears to spend a relatively large amount on lone parents, but a relatively very small amount on low-income groups, simply because of the way assistance is categorised in different countries.

<sup>8</sup> The OECD analysis does not include tax expenditures on pensions because of the absence of comparable data across OECD countries and the fact that pension tax expenditures may benefit people in the future, whereas welfare spending benefits people now. What data are available suggest that Australia has the second highest level of pension tax expenditures in the OECD (Adema and Ladaïque, 2005)

<sup>9</sup> This does not include pensions and lump sums paid out as a consequence of the Superannuation Guarantee (SG), as the SG is not mature and it is not possible to separate out the share of total superannuation payouts that arise from mandatory provisions compared to voluntary contributions. In 2001, total employer contributions to superannuation amounted to close to 4% of GDP, with member contributions increasing this to around 7.5% of GDP.

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<sup>10</sup> Other forms of redistribution can occur as well: for example, between generations, between men and women, or across geographical regions, but these are usually a by-product of the two main objectives rather than being primary goals in their own right.

<sup>11</sup> There are other forms of targeting possible, such as benefits directed to particular geographic areas; these are more common in low-income countries.

<sup>12</sup> Individuals are ranked on the basis of equivalised household disposable income; for details, see Förster and Mira D'Ercole (2005).

<sup>13</sup> Analysis of trends over time shows that targeting – using this measure – has increased in Australia, Denmark, the Czech Republic, the United Kingdom and the Netherlands (and Mexico and Turkey from extremely low bases), and has gone up and then down in New Zealand, and to a lesser extent in Finland and Sweden. In the case of the US, targeting appears to have declined since the 1970s. However, in the US assistance provided through the tax system has become more generous to low income families with children, particularly the Earned Income Tax Credit and more recently, the Child Tax Credit.

<sup>14</sup> In Mexico the middle 60% receive only 35% of transfers, because the richest 20% of households receive more than half the transfers paid. This pattern is not uncommon in lower-income countries, where the social insurance system is usually restricted to those in the formal economy and there is a large, uncovered agricultural sector.

<sup>15</sup> This is calculated from decile shares rather than individual observations, which will tend to result in higher coefficients for all countries.

<sup>16</sup> In the case of countries where the Gini for private income is bracketed, the surveys do not include separate information on taxes, so this is a measure of post-tax, pre-transfer income, where as everywhere else it is pre-tax and pre-transfer. In Austria, the income definition does not include capital incomes or incomes from self-employment, leading to a likely significant understatement of inequality in private and disposable incomes.

<sup>17</sup> While age pensions are more progressively distributed in Australia than in Finland, housing benefits and a group other benefits are very pro-poor in Finland.

<sup>18</sup> The extremely low progressivity of taxes in Switzerland appears result from a concentration of the self-employed in the two lowest deciles in Switzerland, who report low incomes, but nevertheless pay quite a high share of taxes.

<sup>19</sup> It is possible to apply the progressivity of the formula to measures of social spending as a percentage of GDP; when this is done, very similar results are achieved. However, social spending in the national accounts includes items that do not accrue to private households (e.g. benefits received by people in hospitals and nursing homes).

<sup>20</sup> Taking a narrower definition of the poor – the bottom decile rather than quintile – changes the size of net redistribution to the poor – but does not change Australia's ranking.

<sup>21</sup> The 1998 OECD estimates contain a measurement error, because churning was calculated as the simple average of the level of "unnecessary" taxes or transfers, but it is necessary to weight the average to reflect differences in the proportion of private income in different income deciles. When this is done, the calculated level of churning for Australia fell from 6.5 per

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cent of income before taxes and transfers to 4.25 per cent.

<sup>22</sup> The choice of the appropriate denominator – disposable income or taxes or transfers themselves - depends on one's view of why churning is a problem. If churning is seen as a problem of broader economic efficiency, then private income could be regarded as the appropriate basis for comparison.

<sup>23</sup> These estimates come from OECD (2003), with the following approach used in calculating the figures. Only people below the age of 65 years are included, so these are estimates of the proportion of the population of working-age receiving a payment. Benefit receipt is counted on a full-time equivalent basis, that is, individuals count for less than one full-time equivalent if their benefit is paid at less than the normal rate. However, certain benefits may not be reduced when the beneficiary works, or may not be affected by part-time work when earnings and hours remain below a threshold, so these people who are counted as a full-time beneficiaries may also be working part-time, and in some cases even full-time. The numbers include only the beneficiary whose social risk (*e.g.* unemployment or disability) generates the entitlement to benefit, even if the person has a dependent spouse. The definition excludes people with student grants, participants in full-time active labour market (training and employment) programmes, and benefits designed to supplement income from full-time work, such as family payments or housing benefits.

<sup>24</sup> One should be particularly cautious in the absence of data, but it seems very likely that benefit receipt would be lower than Australia in Korea, Mexico and Turkey, and possibly in Switzerland, Iceland, Portugal, and Norway. It is plausible that benefit receipt would be higher in Finland, the Czech Republic, Hungary, Luxembourg and Poland. In the case of Greece and Italy, it is difficult to say because in general their support to people of working age is very low, but early retirement is very extensive.

<sup>25</sup> For example, data from the mid-1990s showed that while the level of worklessness among individuals in Spain was nearly 70 per cent higher than the level in Australia, the level of workless households was about 25 per cent higher. This is a result of very significant differences in household composition in the two countries. In both countries worklessness is particularly high among households comprising a single adult without children (33 per cent in Australia and 47 per cent in Spain). However, around 17 per cent of all households of working age in Australia are single persons, while in Spain the corresponding proportion is around 5 per cent. Correspondingly, more than half of all working-age households in Spain contained three or more adults (with and without children), while in Australia the figure was around one-quarter of all working-age households.

<sup>26</sup> Of course very few people - if any - actually receive this maximum amount, because it would be payable to someone who had earned around 4 times the average wage. This is a very small group in the workforce, and they have a very low probability of unemployment.