



## Money for nothing? Australia in the global middle class welfare debate

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### Executive summary

- Middle class welfare has been a controversial issue in policy debates in Australia in recent years
- This research paper seeks to contribute to understanding of key issues in the debate about middle class welfare through an examination of comparative research into different welfare systems
- The research examined in the paper suggests that the issues relating to middle class welfare are more complex than generally suggested in the various debates on this topic in Australia and overseas
- First, the paper finds that access by the middle class to the Australian income support system is relatively low compared with other countries. Nonetheless, there is significant use of welfare benefits and services by the middle class
- Second, the paper argues that welfare systems that have high levels of middle class involvement are associated with good outcomes in areas such as redistribution, productivity and support for welfare institutions. The paper also examines evidence on the issue of social cohesion but the absence of comparative data makes it difficult to draw firm conclusions.
- Further, targeting through means testing is not necessarily the panacea that many suggest it to be (particularly, where it gives rise to high effective marginal tax rates, poverty traps and other unintended consequences)
- Importantly, arguments in favour of universal welfare *systems* should not necessarily be seen as arguments for middle class access to particular welfare *programs*—indeed, arguably, in some cases, middle class welfare might be said to undermine key objectives of universal welfare systems
- Finally, the paper suggests that the global economic crisis is likely to give rise to increasing debate about the fundamental nature of the Australian welfare state in coming years and that this will most likely involve significant discussion of issues related to middle class welfare. These debates are more likely to be productive if they take into consideration evidence from comparative welfare studies, as well as the need for clarity about the values and objectives underpinning particular perspectives.

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## Introduction

The appropriate level of access by those on middle and high incomes to welfare benefits and services (popularly known as ‘middle class welfare’) has been a controversial issue in policy debates in recent years.<sup>1</sup> The introduction of new means tests in the first Rudd Government Budget and the expectation of further means testing in the second has led to renewed debate about the pros and cons of universal versus targeted access to benefits and the government’s future intentions in this policy area.

Debate about access to welfare by the non-poor can be particularly emotive. The term middle class welfare, itself generally used as a pejorative, is often described by critics in terms such as ‘shameless’, ‘outrageous’ and ‘unjust’. Defenders of access to welfare programs by the non-poor can be similarly emotive. For example, in criticising the Rudd Government’s decision to means test the Baby Bonus (a payment of \$5000 to help with the extra costs of a new baby or adopted child), the then Liberal Party leader, Dr Brendan Nelson, made the following comments:

Every mother loves her baby. Every baby is valued and Mr Rudd should value all babies equally. We should not live in an Australia where Mr Rudd thinks that some babies are more valuable than others and it’s very important that the Government make sure that families, men and women that are trying to raise children in this country, continue to receive the support that they have over the last decade of the Howard Government.<sup>2</sup>

In other instances, those speaking against non-poor access to particular welfare programs have been criticised for practicing the ‘politics of envy’.<sup>3</sup>

In addition, debates about middle class welfare can be confusing. In part, this is because of the complex nature of the subject matter. An additional factor may be that such debates rarely fit neatly into a simple left/right dichotomy: supporters and opponents of non-poor access to welfare exist across the political spectrum. For example, in recent times, Liberal Party frontbencher, Tony Abbott, and left-wing academic, Eva Cox, have both argued for the benefits of universal welfare and against means testing of particular benefits.<sup>4</sup> At the same

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1. The term ‘middle class welfare’ is used broadly in this paper to refer to any form of welfare that may be accessed by people other than the poor. As such, throughout the paper, the terms middle class and non-poor are used synonymously. Given that the terms are used broadly, rather than analytically, neither term is defined in the paper.
  2. B Nelson (Leader of the Opposition), *Transcript of the Hon. Dr Brendan Nelson MP joint doorstep interview with the Hon. Mr Ian Macfarlane, Toowoomba*, media release, 2 May 2008.
  3. See for example D Moore, ‘Who’s too rich to get welfare?’, *Australian*, 15 May 2008; K Donnelly, ‘ALP schools policy: engaging in the politics of envy’, *Online Opinion*, 28 September 2004, viewed 11 February 2009  
<http://www.onlineopinion.com.au/view.asp?article=2590>
  4. T Abbott, ‘Even the rich need a helping handout’, *Australian*, 21 April 2008; E Cox, ‘Means tests: middle class welfare or redistributive fairness’, *Centre for Policy Development*, 8 May

time, members of the Rudd Government and the right-wing Centre for Independent Studies have both criticised middle class welfare (though, for different reasons).<sup>5</sup> To further complicate the picture, many who argue in favour of universal access to public services such as health and education, are also strong advocates of means testing of welfare benefits such as the age pension.

As can be seen below, this is not a new debate. The question of whether the non-poor should have access to welfare has been contested for as long as governments have been involved in welfare—most recently, following the shift towards greater targeting of welfare in many countries from around the 1970s.

This research paper seeks to contribute to understanding of key issues in the debate about middle class welfare. The paper begins by placing Australian middle class welfare in an international context: how does the ‘Australian way’ of welfare differ from that of other countries? How do levels of middle class welfare in this country compare with levels in other countries? How are these two issues interconnected? The paper then turns to its most important task: an examination of research related to the debate about middle class welfare. The point of this is to discover whether this research (much of it based on comparisons of different types of welfare systems) can yield general principles that might inform the Australian debate.

The research examined in the paper suggests that the issues relating to middle class welfare are more complex than generally suggested in the various debates on this topic in Australia and overseas. Broadly, it should be possible to determine whether middle class access to the welfare state is a good or bad thing by examining empirical evidence (where such evidence exists) about the performance of various forms of welfare state against an agreed series of indicators of success. While the range of such indicators is potentially limitless, this paper, following an examination of the relevant literature, has narrowed the field to five: technical problems, redistribution, productivity, welfare politics and social cohesion.

However, as shall be discussed, the existing empirical evidence (which is often highly contested) can only take discussion of the issue of middle class welfare so far before running into the even more hotly contested terrain of objectives, ideologies, principles and values. That is, questions about the desirability of middle class welfare cannot be separated from questions about precisely what we want the welfare state to do (and why).

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2008, viewed 16 February 2009, <http://cpd.org.au/article/mean-tests-middle-class-welfare-or-redistributive-fairness>

5. See for example, the Treasurer, Wayne Swan, quoted in K Perry, ‘Tax reforms target battlers’, *news.com.au*, viewed 16 February 2009, <http://www.news.com.au/business/money/story/0,25479,23693620-14327,00.html>; P Saunders, *Means testing doesn’t solve the problems with welfare policy*, Centre for Independent Studies, Executive Highlights no. 615, 15 May 2008, viewed 16 February 2009, [http://www.cis.org.au/executive\\_highlights/EH2008/eh61508.html](http://www.cis.org.au/executive_highlights/EH2008/eh61508.html)

## **Welfare and related concepts**

At its broadest, this paper is concerned with the appropriate scope of welfare arrangements. The term welfare has both a general and a more specific meaning. The welfare policy area involves a wide range of interrelated concepts and terms, whose meanings are often assumed, rather than explained. This can have the effect of confusing the issues to be discussed, particularly where, as often happens, terms are used interchangeably.

At its broadest, **welfare** may refer to ‘well-being, happiness; health and prosperity (of a person or a community et cetera)’.<sup>6</sup> It may also refer to arrangements aimed at ensuring or bringing about well-being. Thus, a useful definition of welfare is that it is that which ‘refers to the well-being of individuals or groups and, by implication, those measures which can help to ensure levels of well-being through provision of education, health services, managed housing, and social security benefits’.<sup>7</sup> The term ‘**welfare state**’ refers to arrangements where provision of such measures is principally the responsibility of the state. Specifically, it refers to those policy arrangements supporting the substantial expansion of state responsibility for welfare in many countries following World War II.

It should be noted that welfare need not *necessarily* refer exclusively (if at all) to any particular measures such as those in the definition above (education, health, social security et cetera). If one agrees that welfare refers to measures aimed at ensuring the well-being of citizens, then, arguably, it could refer to a much larger range of categories, including the provision of roads, police services, public transport, policies aimed at addressing environmental degradation and so forth.

Further, economic and industrial relations policies are intimately connected with welfare policy objectives (particularly, as shall be discussed below, in Australia where, traditionally, welfare objectives have also been pursued through alternative means such as wage arbitration and employment policy).<sup>8</sup> Nevertheless, in the interests of simplicity (and given the way the term is generally used), the following discussion will assume that welfare *mainly* refers to measures in the areas of social security (pensions, unemployment benefits etc), and health, education and housing services.

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6. ‘welfare’ *n.* in B Moore, ed., *The Australian Oxford Dictionary*, 2nd edition, Oxford University Press, 2004, viewed 28 January 2009, <http://www.oxfordreference.com/views/ENTRY.html?subview=Main&entry=t157.e62067>
  7. ‘welfare’ in J Scott and G Marshall, *A Dictionary of Sociology*, Oxford University Press, 2005, viewed 30 October 2008, <http://www.oxfordreference.com/views/ENTRY.html?subview=Main&entry=t88.e2486>
  8. P Smyth and M Wearing, ‘After the welfare state? Welfare governance and the communitarian revival’, in S Bell, ed., *Economic governance and institutional dynamics*, South Melbourne, Oxford University Press, 2002, p. 227; F Castles, *The working class and welfare : reflections on the political development of the welfare state in Australia and New Zealand, 1890-1980*, Wellington, Allen & Unwin, 1985.

As shall be explained below, consistent with changing conceptions of the role of government, over time the concept of welfare has expanded to encompass not simply social amelioration (more or less direct attempts to address social disadvantage and inequality) but also attempts to address the causes of disadvantage and inequality. Thus, the concept of welfare can include remedial, preventative and developmental approaches.<sup>9</sup>

## Key terms

**Means testing**<sup>9</sup> refers to a process used to identify people with limited resources, usually involving an assessment of the income and capital of a person or family. Means tests are generally applied in order to determine eligibility for welfare benefits or services. They are also used to determine whether (or the extent to which) particular charges or fees will be applied to particular individuals (for example, co-payments associated with access to subsidised medicines).

Means tests are the primary method for determining eligibility in selectivist welfare systems. **Selective** benefits and services are those reserved for ‘people defined within the context of the policy as in need (usually financial need)’.<sup>10</sup> Selectivism can be contrasted with **universalism**, which refers to ‘services and benefits available to everyone as a right, or at least to whole categories of people for example, ‘the aged’’.<sup>11</sup> It is important to recognise, though, that almost every welfare state arrangement contains a *combination* of universalism and selectivism and hence can be located on a spectrum between the two. The term, **encompassing**, is used to describe welfare approaches that combine universal access with earnings-related benefits (that is, not only do the non-poor participate but this participation is at a level intended to more or less replaces the recipient’s previous income).<sup>12</sup>

The term **targeting** is often used synonymously with means testing or selectivism. However, it is also used to refer to the broader range of efforts at selecting welfare recipients, including categorisation according to particular areas such as the disabled, the unemployed and so forth.

Universality and selectivity are related to the concepts institutional welfare and residual welfare. **Institutional welfare** refers to systems in which risks (e.g. unemployment, ill health) are accepted as social costs. As a result, in institutional systems welfare is provided for the population as a whole as a right of citizenship, rather than just for the poor or needy.

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9. Smyth and Wearing, p. 232

10. A Elliot, *Is Medicare universal?*, Research note, no. 37, 2002–03, Parliamentary Library, Canberra, 2003, p. 1.

11. Elliot, p. 1.

12. W Korpi and J Palme, ‘The paradox of redistribution and strategies of equality: welfare state institutions, inequality, and poverty in western countries’, *American sociological review*, no. 63, 1998, p. 669.

On the other hand, **residual welfare** refers to systems where welfare functions as a safety net for those defined as in need where other institutions such as the market or family have failed. The key difference between institutionalism/residualism and universalism/selectivism is that the former are principles, while the latter are methods.<sup>13</sup>

In discussing welfare arrangements it is also important to understand the difference between contributory and non-contributory models of welfare. **Contributory** models are those that require some level of financial contribution by members as a condition of access to welfare benefits (e.g. social insurance for income support for the elderly). In such systems, benefits may either be related to level of contribution over time or at a flat rate based on some assessment of basic needs. On the other hand, **non-contributory** models are those that provide access to welfare benefits drawn from public funding, rather than through individual contributions to an insurance pool (such as the aged pension in Australia and New Zealand).

### **International context: classifying welfare states**

Just as important as clarifying the variety of interrelated concepts and terms in the welfare policy area is the need to provide some explanation of the different kinds of welfare state arrangements. This is necessary because welfare policy debates, including the debate about middle class involvement, frequently invoke international evidence and examples. However, such comparisons can lead to confusion without a proper appreciation of the range of similarities and differences between different kinds of welfare states.

An important contrast between welfare states relates to their different objectives, particularly in the type of redistribution pursued. The type of redistribution probably most familiar to Australians is what has been called the **Robin Hood** objective: taking from the rich to give to the poor.<sup>14</sup> This objective tends to be associated most strongly with selective approaches to welfare on the grounds that it allows expenditure to be concentrated on those most in need (though, as discussed below, this assumption is contested by proponents of universal welfare).

The primary objective of most welfare states, however, is what has been called the **piggy bank** objective.<sup>15</sup> This refers to the objective of providing income maintenance aimed at addressing adverse life contingencies (for example, unemployment, disability, sickness). It also refers to redistribution 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)'.<sup>16</sup> The idea is that individuals, either through taxation or participation

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13. Elliot, p. 1.

14. N Barr, *The welfare state as piggy bank: information, risk, uncertainty and the role of the state*, Oxford University Press, Oxford, 2001.

15. Barr.

16. P Whiteford, 'Targeting, redistribution and poverty reduction in OECD countries', Conference paper, *Welfare state feedbacks: from outcomes to inputs*, Store Restrup Herregaard, Aalborg,

in social insurance, effectively ‘save’ throughout their lives in order to ensure they are protected against the various risks to their incomes that occur throughout the life course.

It is important to note that all welfare states involve some combination of Robin Hood and piggy bank objectives, with the overall mix differing considerably between countries.<sup>17</sup> For example, according to one estimate, in Australia around 38 per cent of lifetime benefits received by individuals were paid for by taxes paid at another stage in their lifecycle, while 62 per cent involved redistribution from rich to poor. At the same time, the situation in the United Kingdom was reversed, with only 38 per cent of benefits representing redistribution between rich and poor.<sup>18</sup>

Perhaps the most widely accepted attempt to classify welfare states is Gosta Esping-Anderson’s ‘three worlds’ typology.<sup>19</sup> The ‘three worlds’ approach examines specific programmes in particular countries in order to evaluate the extent to which a given welfare state can be considered to secure the livelihood of welfare recipients independently of the market. From this, Esping-Anderson classifies welfare states (or ‘welfare regimes’, as he prefers to call them) as either ‘Liberal’, ‘Conservative’ or ‘Social Democratic’.

**Liberal** welfare regimes are essentially those in which, for example, private sources of income replacement, private expenditure on health and means tested social security benefits are most prevalent. Welfare arrangements in these countries are selectivist and residual. Benefits are ‘supposed to go to the poor and only the poor; and they are supposed to be sufficient only to cover bare subsistence needs’.<sup>20</sup>

Broadly, the emphasis of Liberal welfare regimes is on economic growth—poverty and other forms of disadvantage are targeted in a way that infringes only minimally on the market.<sup>21</sup> Liberal regimes are particularly concerned to avoid creating disincentives to participate in the

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Denmark, January 31-February 2 2007, p. 4, viewed 23 March 2009, [http://72.14.235.132/search?q=cache:xnKesfFo6iwJ:www.socsci.aau.dk/ccws/Conference-2007/papers/Whiteford-Targeting\\_2January\\_2007.doc+Targeting,+redistribution+and+poverty+reduction+in+OECD+countries%E2%80%99+peter+whiteford&cd=2&hl=en&ct=clnk&gl=au](http://72.14.235.132/search?q=cache:xnKesfFo6iwJ:www.socsci.aau.dk/ccws/Conference-2007/papers/Whiteford-Targeting_2January_2007.doc+Targeting,+redistribution+and+poverty+reduction+in+OECD+countries%E2%80%99+peter+whiteford&cd=2&hl=en&ct=clnk&gl=au)

17. Whiteford, 2007, p. 4.

18. Whiteford, 2007, p. 4.

19. G Esping-Anderson, *The three worlds of welfare capitalism*, Polity Press, Cambridge, 1990; F Castles, ‘Developing new measures of welfare state change and reform’, *European Journal of Political Research*, no. 41, 2002, pp. 613-41; F Castles and D Mitchell, *Three worlds of welfare capitalism or four?*, Graduate Program in Public Policy, Discussion Paper No. 21, Australian National University, 1990, p. 5.

20. R Goodin, B Headey, R Muffels and H Dirven, ‘The real worlds of welfare capitalism’, in C Pierson and F Castles, eds, *The welfare state reader*, Polity Press, Malden, 2000, p. 172.

21. Goodin and others, 2000, p. 173.

labour market. According to Esping-Anderson, the Liberal world of welfare includes such countries as Australia, the United States, the United Kingdom, New Zealand, Canada and Ireland.

**Conservative** welfare regimes have contributory social insurance as their cornerstone. The level of benefits received is directly related to the level of contributions paid into the insurance pool. For example, insurance benefits received by those unable to work are a direct function, and a large fraction, of what the person used to earn when they were in work.<sup>22</sup> Conservative welfare regimes therefore provide stability to the earner's income stream and, more broadly, the existing social order. This has been referred to as the St Matthew approach to welfare: to those who have, more shall be given.<sup>23</sup>

For Esping-Anderson, Conservative regimes are barely more egalitarian than Liberal ones because 'the state's emphasis on upholding status differences means that its redistributive impact is negligible'.<sup>24</sup> Conservative regimes are also characterised by the principle of 'subsidiarity'—meaning that benefits are available only when family resources are exhausted.<sup>25</sup> This promotes dependence on the traditional family. The Conservative world includes nations such as Austria, France, Germany and Italy.

Finally, the **Social Democratic** world is characterised by universal benefits and a high degree of benefit equality.<sup>26</sup> Rather than simply addressing minimal needs (as is the case with Liberal regimes), Social Democratic regimes seek 'an equality of the highest standards'.<sup>27</sup> All enjoy essentially the same rights in that, for example, all social strata are incorporated under the same universal social insurance scheme. While benefits in Social Democratic regimes are high compared with other regimes, they are also graduated according to accustomed earnings. According to Esping-Anderson, this combination of universal participation and comparatively high benefits promotes 'an essentially universal solidarity in favour of the welfare state'.<sup>28</sup>

Social Democratic regimes also seek full employment both in order to provide the income necessary to finance their generous redistribution schemes and because the right to employment is regarded as equal in status to the right to income protection. In contrast to Conservative regimes, the Social Democratic world of welfare seeks to enable individual independence from the traditional family through, for example, direct payments to children,

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22. Goodin et al, 2000, p. 173.

23. Korpi and Palme. 2004, p. 153.

24. Esping-Anderson, p. 27.

25. Esping-Anderson, p. 27.

26. Castles and Mitchell, p. 11

27. Esping-Anderson, p. 28.

28. Esping-Anderson, p. 28.

and taking direct responsibility for caring for children, the aged and the helpless.<sup>29</sup> The Social Democratic world includes the Netherlands, Denmark, Norway and Sweden.

While, for Esping-Anderson, Australia belongs to the Liberal world, there is an argument that this does not adequately capture the unique nature of Australia's welfare arrangements. According to one analysis, rather than the Liberal world, Australia, in fact, has traditionally belonged to a fourth '**Radical** world of welfare' (which also includes New Zealand).<sup>30</sup> This Radical world is based on the principles of what Castles calls the 'wage earner's welfare state' in which 'social amelioration Australian-style' has traditionally been pursued via regulation of the wage relationship (through compulsory conciliation and arbitration of industrial disputes).<sup>31</sup> This has elsewhere been referred to as the 'Australian way of welfare' or 'social protection by other means'.<sup>32</sup>

While critics have suggested a range of problems with the idea of a fourth, radical world (including its continued relevance as a category given changes to industrial relations in Australia since the early 1990s), Castles argument does much to highlight both the unique nature of Australia's arrangements when compared with others overseas and the complexity of international comparisons of welfare states in general.

## **The middle class and Australian welfare**

Australia is unique among Western countries for the extent to which its social welfare programs are means tested. Income support is extended across a range of categories, including the old, people with a disability, the unemployed and people caring for children. This support is provided on a flat rate basis and funded from general taxation, rather than from contributions from workers. The Australian system of income support differs from those in most other welfare states in that it is not based around social insurance, whereby, for example, the old, unemployed and sick are protected by earnings related income replacement schemes. Consequently, Australian welfare benefits are generally lower than in other welfare states.<sup>33</sup>

In addition to means tested income support, as noted above, Australia also has a non-means tested national health insurance scheme, Medicare. The principal components of Medicare are free or subsidised treatment by practitioners such as doctors, free treatment as a public (Medicare) patient in a public hospital, and free or subsidised access to prescription

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29. Esping-Anderson, p. 28.

30. Castles and Mitchell, p. 5.

31. F Castles, 'A Farewell to Australia's welfare state', *CEDA Bulletin*, March 2001, p. 54.

32. P Smyth, 'Closing the gap? The role of wage, welfare and industry policy in promoting social inclusion', *Journal of industrial relations*, vol. 50, no. 4, 2008, p. 648.

33. P Mendes, *Australia's welfare wars revisited*, UNSW Press, Sydney, 2008, p. 15.

medicines under the Pharmaceutical Benefits Scheme (PBS).<sup>34</sup> Australia also provides a range of incentives for people to take out private health insurance, including a substantial, non-means tested rebate for the cost of premiums (35 per cent for those aged over 65, 40 per cent for over 70s, and 30 per cent for all others).<sup>35</sup>

The highly selective nature of Australia's income support arrangements means that it traditionally has less middle class welfare than virtually all other developed countries, including other low-spending countries such as the USA and Japan.<sup>36</sup> This is illustrated by the low share of direct social security transfers in Australia going to the richest households. For example, a 2000 Organisation for Economic Cooperation and Development (OECD) study found direct transfers to the richest 30 per cent of households of workforce age in Australia to be 6.5 per cent, the lowest of 21 OECD countries studied, substantially lower than most other countries.<sup>37</sup>

While, overall, access by the middle class to the Australian income support system has been lower than other countries, it is also fair to say that there is some significant use of welfare benefits and services by the non-poor. While the majority of pensioners have low incomes (over half have less than \$20 a week of private income), around 5 per cent have private incomes of over \$400 a week.<sup>38</sup>

According to the Rudd Government's 2008 Pension review (known as the Harmer review) background paper:

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34. Australian federalism has traditionally divided 'cash' from 'care'. This means that while (as can be seen above) the Commonwealth has taken responsibility for income support benefits and health care rebates, welfare services have been the domain of the states and territories. Thus, for example, each of the states and territories provides free, non-means tested public education and hospitals, and means tested access to public housing (each with differing levels of Commonwealth support). For reasons of simplicity, this paper will focus on benefits provided by the Commonwealth Government. Nevertheless, many of the issues raised in the paper will also apply to welfare provided by the states and territories.
  35. The Rudd Government was expected to announce the introduction of a means test for the rebate in the 2009-10 Budget.
  36. P Whiteford and G Angenent, *The Australian system of social protection—an overview (second edition)*, Occasional paper no. 6, Department of Family and Community Services, 2002, p. 49.
  37. Cited in Whiteford and Angenent, p. 47. While the above highlights the progressive nature of Australia's income support arrangements, this does not necessarily mean that the Australian system is effective at redistribution. The quantum of benefits is the other key factor in the redistributive impact of income support. This will be discussed in further detail in a subsequent section of the paper.
  38. J Harmer, *Pension review: background paper*, Department of Families, Housing, Community Services and Indigenous Affairs, 2008, executive summary.

Those income support recipients who do have significant levels of private income are able to achieve living standards well above the base rate of pension. While rewarding people who have private income is important to the way the income support system operates ... it also results in considerable variations in the living standards of recipients of transfer payments.<sup>39</sup>

The Harmer review background paper notes that the slow withdrawal rate of the Age Pension as private income increases means 'there is a small but significant group of people receiving Age Pension who have household income over one-and-a-half times the Age Pension rate' and 'some four per cent receive incomes more than double the Age Pension rate'.<sup>40</sup> Further, it suggests that the proportion of age pensioners with significant levels of private income 'is expected to grow in the future as the Superannuation Guarantee matures'.<sup>41</sup>

As is the case with income, Australia's income support arrangements allow some recipients to have substantial private wealth or live in households with others who have considerable assets. Pensioners can receive some pension even with assessable assets up to around \$1 000 000. Again, while most pensioners do not have substantial savings or other assets, 5 per cent have assessable assets over \$250 000.<sup>42</sup> According to the Harmer paper, 'more than 20 per cent of households relying on the Age Pension and related payments had net assets of over half a million dollars, as do almost 15 per cent of those with Carer Payment as their main source of income and around 10 per cent of those with Disability Support Pension as their main source of income'.<sup>43</sup>

There is very little evidence available on the extent of use of Medicare and government-funded private health incentives by the non-poor. What evidence there is suggests that, as might be expected of non-means tested programmes, there is substantial use by the non-poor. Indeed, there is even evidence to suggest that, in some instances, poorer Australians are particularly disadvantaged in comparison to those who are better off in accessing Medicare and government private health incentives. For example, there is evidence that:

- the level of bulk-billed GP services through Medicare (that is, those that do not attract a patient co-payment) is higher in wealthier electorates (though the relationship is complex and probably explained by region as much as by income)<sup>44</sup>

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39. Harmer, p. 50.

40. Harmer, p. 51.

41. Harmer, p. 51.

42. Harmer, p. 51.

43. Harmer, p. 54.

44. I McAuley, *Bulk billing by income/electorate*, Australian Consumers' Association, Marrickville, NSW, 2003.

- the benefits from the private health insurance rebate are concentrated in the wealthiest households. More than half goes to the top 20 per cent of taxpayers and nearly three-quarters goes to the top 40 per cent<sup>45</sup>
- the Medicare Safety Net, introduced in March 2004 to provide financial relief for people facing high out-of-pocket costs for out-of-hospital medical services, provides significantly higher benefits in electorates with relatively high median family income and lower health care needs<sup>46</sup>
- Aboriginal and Torres Strait Islander people have low levels of access to, and use of, health services such as Medicare, the Pharmaceutical Benefits Scheme (PBS) and private GPs. Combined expenditure on Medicare and the PBS contributed 6.6 per cent of total health expenditure on Indigenous people in 2001–02, compared with 23 per cent for non-Indigenous people.<sup>47</sup>

In summary, while there is very little data available, it is likely that there is substantial use by the non-poor of Australia's national health insurance programme, Medicare, and the government's private health insurance incentives.<sup>48</sup>

## **Developments over recent decades**

From the 1980s, there was increased support for means testing among policy makers and international institutions such as the International Monetary Fund and the World Bank. For example, the World Bank argued that 'a comprehensive approach to poverty reduction ...

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45. J Smith, *How fair is health spending? The distribution of tax subsidies for health in Australia*, The Australia Institute, no. 43, October 2001, p. v.

46. K van Gool, E Savage, R Viney, M Haas and R Anderson, *Who's getting caught? An analysis of the Australian Medicare Safety Net*, CHERE working paper 2006/8, Centre for Health Economics Research and Evaluation, 2006.

47. Australian Institute of Health and Welfare (AIHW) Aboriginal and Torres Strait Islander Health and Welfare Unit, *Health expenditure*, AIHW, viewed 27 November 2007 <http://www.aihw.gov.au/indigenous/health/expenditure.cfm>

48. This is often presented as a reason for moving towards a more selectivist model of Medicare by individuals and groups advocating for changes to the current funding model for health in Australia, such as Medical Savings Accounts (MSAs). The argument generally made is that it is wrong for people to access the public system (and hence 'take up a bed' that could be used for a non-wealthy person) when they could afford to use the private system. An alternative approach might be to pursue policies aimed at addressing inadequate access by the non-wealthy to Medicare and other health services. For example, Duckett has suggested the value in pursuing 'place based' initiatives which 'provide coordinated services to enhance access to needed services as well as investments in community development, prevention and self management'. S Duckett, 'The Australian health care system: reform, repair or replace?', *Australian Health Review*, vol. 32, no.2, 2008, p. 324.

calls for a program of well-targeted transfers and safety nets'.<sup>49</sup> This shift in thinking occurred concurrently with (indeed, some argue, as a result of) what is known as the 'fiscal crisis of the state'—that is, the emergence of a 'structural gap' in advanced capitalist societies between state revenues and expenses from around the 1970s.<sup>50</sup> There has been a strong emphasis on means testing in international policy debates since this time.<sup>51</sup>

There were indications throughout the 1960s and 1970s of the possibility of a move towards greater institutionalism/universalism in Australia—for example, Labor's efforts to introduce Medibank/Medicare and bipartisan support for a universal aged pension up until the late 1970s. However, the Australian welfare state turned in the direction of strengthened means testing under the Hawke-Keating Labor governments—for example, new means tests were introduced for the age pension and family payments. Subsequently, in less financially stringent circumstances, the Howard Government then both relaxed a number of existing means tests and introduced a series of new non-means tested initiatives, including Family Tax Benefit Part B, the Baby Bonus, the private health insurance rebate and the First Home Owners Grant Scheme.

Some have also argued that middle class welfare was expanded through Howard Government superannuation initiatives. For example, under the Howard Government superannuation guarantee, income after age 60 became tax free and does not need to be declared as extra income for tax purposes. As columnist, Mike Steketee explains, 'that means people enjoying \$100 000 or \$200 000 a year from their super can be treated as low-income earners. They can qualify for the Government's Low Income Tax Offset, the Senior Australians Tax Offset and a higher threshold for the Medicare levy'.<sup>52</sup>

Such developments under the Howard Government have been criticised by some commentators as a shift in the philosophy that welfare should be directed at those most in need (selectivism). The former prime minister, John Howard, defended this shift on the grounds that it was intended to 'support families in the choices they wish to make' and 'help families struggling with the challenges of modern life'.<sup>53</sup>

It has been common to interpret developments under the Howard Government as reflecting political objectives—that is, as one commentator has expressed it, 'the temptations for office

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49. World Bank, *World Development Report*, Oxford University Press, New York, 1990.

50. J O'Connor, *The fiscal crisis of the state*, St. Martin's Press, New York, 1973.

51. Korpi and Palme, 1998, p. 664.

52. M Steketee, 'To those who have, more shall be given', Mike Steketee blog, *Australian online*, 20 March 2008, viewed 17 February 2009, [http://blogs.theaustralian.news.com.au/mikesteketee/index.php/theaustralian/comments/to\\_those\\_who\\_have\\_more\\_shall\\_be\\_given/](http://blogs.theaustralian.news.com.au/mikesteketee/index.php/theaustralian/comments/to_those_who_have_more_shall_be_given/)

53. J Howard (Prime Minister), 'Australian Families: Prosperity, Choice and Fairness', address to the Menzies Research Centre, Westin Hotel, Sydney, 3 May 2005.

holders to buy votes'.<sup>54</sup> An alternative explanation has focused on the ideological basis for Howard Government welfare policies. That is, policies such as increased spending on private schools and incentives to take out private health insurance reflected Liberal Party policy priorities such as 'choice', self-reliance and private (as opposed to public) provision of services. Further, non-means tested expenditure in the area of family payments has been said to reflect the longstanding Liberal Party priority of supporting the traditional family.<sup>55</sup>

Conservative commentator, Andrew Norton, has described the phenomenon of substantial state expenditure in areas of welfare policy consistent with right of centre ideological objectives as 'big government conservatism'.<sup>56</sup> Elsewhere, it has been described as 'conservative welfarism'.<sup>57</sup> It could be argued that, using Esping-Anderson's three worlds typology described above, the Howard Government sought to combine elements of both the Liberal and Conservative welfare regimes. That is, a combination of the Liberal regime emphasis on the free market with the Conservative regime emphasis on supporting traditional social institutions such as the family.

The move towards greater means testing under the Rudd Government has led to conjecture about whether this is simply a response to fiscal exigencies (most evident in the emergence of the global financial crisis) or possibly an indication of a broader philosophical turn towards greater targeting. This, in turn, has led to debates about the pros and cons of middle class welfare and, more generally, the pros and cons of different types of welfare state arrangements. The remainder of this paper is devoted to an examination of key aspects of such debates.

## **Middle class welfare: for better or worse?**

This section examines some of the main theoretical and empirical arguments used in international debates about middle class welfare. These arguments are organised according to five categories: technical problems, redistribution, productivity, welfare politics and social

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54. D Moore, 'When will the Leviathan fade away?', *Policy*, vol. 22, no. 3 (Spring 2006), p.16. See also A Leigh, 'Help the poor, and cut taxes', *Australian financial review*, 1 November 2007.

55. A Norton, 'The rise of big government conservatism', *Policy*, vol. 22, no. 4, 2006-07, p. 20. Norton has criticised this expenditure on the grounds that there is no family income data or survey evidence 'that families with children typically feel more financial pressure than other households' and that 'for most couples, children coincide with the financial capacity to raise them'. In terms of this connection, it is interesting to note former Howard Government Finance Minister, Senator Nick Minchin's description of paid maternity leave as 'middle class welfare'. 'Maternity leave is "middle-class welfare": Minchin', *ABC news online*, 13 September 2002, viewed 11 February 2009, <http://www.abc.net.au/news/newsitems/200209/s675407.htm>

56. Norton.

57. W Antle, 'Big government can't conserve', *The American spectator*, 20 April 2005, viewed 11 February 2009, <http://spectator.org/archives/2005/04/20/big-government-cant-conserve>

cohesion. As will be shown, arguments for and against non-poor access are very similar to the arguments for either selective or universal/encompassing approaches to welfare.

### **Technical problems: unintended consequences of means testing**

One of the main objections made against efforts to restrict the middle class from the welfare state relates to a range of technical problems associated with the process and impact of means testing. Common objections along these lines include:

- processes for testing entitlement tend to be intrusive and stigmatising (though, as discussed above, this is widely thought to be less of a problem in Australia than in other countries where means testing is less prevalent)
- difficulties associated with establishing boundaries of exclusion and entitlement—for example, the ‘poverty trap’ that emerges from high effective marginal tax rates<sup>58</sup>
- the possibility of low-uptake of welfare programs arising from barriers to access such as administrative complexity and intrusiveness
- perverse incentives such as penalising those who have made private or independent provision, and
- the administrative costs associated with means tested programs.

While, as noted, some of these are likely to be less of a problem in some settings than in others, there appears to be general acknowledgement among social policy scholars and economists that such problems pose genuine challenges for policy makers. Thus, any potential gains associated with means testing (such as being better able to target the poor for assistance) can be undermined by one or more of the potential problems outlined above.

For example, according to economist, Amartya Sen:

... targeted support can *also* affect people’s economic behaviour. For example, the prospect of losing the support if one were to earn too much can be a deterrent for economic activities. It would be natural to suspect that there would be *some* significant distorting shifts if the qualification for the support is based on a variable (income) that is freely adjustable through changing one’s economic behaviour. The *social* costs of behavioural shifts must include, among other things, the loss of the fruits of economic activities foregone.<sup>59</sup>

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58. The concept of effective marginal tax rates refers to the amount of an additional dollar of income kept by individuals and families, after the payment of income tax and the withdrawal of any means-tested cash payments from government. AMP and the National Centre for Social and Economic Modelling, *Trends in effective marginal tax rates*, Income and Wealth Report Issue 14, September 2006, p. 3.

59. A Sen, *Development as freedom*, Anchor, New York, 1999, pp. 135–6.

As noted above, in addition to the potential cost to the economy overall, means testing also potentially leads to ‘poverty traps’ whereby people make the decision to remain with the ‘devil they know’ (however, meagre the benefits provided), rather than engage in the risks of loss of income associated with participation in the labour market. Importantly, there is evidence that the highest effective marginal tax rates are often experienced by lower income earners, including the unemployed and people with dependent children, including sole parents.<sup>60</sup>

The point of this is not that means testing is inherently problematic but rather, as Sen argues, ‘there are considerations that run counter to simple argument for maximal targeting’.<sup>61</sup> Thus, for example, in the Australian context, while critical of the extent of tax and transfer benefits for those on high incomes, Julian Disney from the University of New South Wales has argued for a relaxation of means testing in certain areas in order to avoid ‘imposing high effective marginal tax rates on lower-income people, especially those who [due to high levels of unemployment resulting from the global financial crisis] can only find part-time or intermittent work’.<sup>62</sup> Disney has called for the relaxing of Newstart Allowance income tests to allow averaging over 3 months or even longer, cutting the withdrawal rate and raising the threshold at which it starts, at least during the current recession’.<sup>63</sup>

## **Redistribution**

One of the main arguments used against non-poor access to welfare is that it diverts limited resources from those who need them to those who do not. Put another way, restricting the non-poor from accessing welfare enables the maximum level of services and benefits to be delivered to those most in need. As such, this argument draws most clearly on the redistributive objectives of welfare.

As discussed above, different welfare states emphasise different kinds of redistribution. Broadly, Australia’s highly targeted system is based around the ‘Robin Hood’ objective of taking from the rich to give to the poor, while most other OECD welfare states emphasise the ‘piggy bank’ objective of either (a) income maintenance or insurance in case of adverse contingencies or (b) redistribution across the life-cycle.<sup>64</sup> However, studies comparing the relative effects of targeted and universal approaches to welfare on redistributive objectives

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60. AMP and the National National Centre for Social and Economic Modelling, p. 5.

61. Sen, p. 137.

62. J Disney, *Taxation, social justice and economic development*, Address to annual congress of the Australian Council of Social Services, Sydney, 3 April, 2008, p. 4, [http://www.wacoss.org.au/images/assets/eNews\\_207/taxation\\_social\\_justice\\_&\\_economic\\_development.pdf](http://www.wacoss.org.au/images/assets/eNews_207/taxation_social_justice_&_economic_development.pdf)

63. Disney, p. 4.

64. P Whiteford, ‘The welfare expenditure debate: ‘economic myths of the left and right’ revisited’, *Economic and labour relations review*, vol. 17, no. 1, 2006, p. 41.

have largely focused on the capacity of each to address poverty and inequality. As such, this section mainly addresses the evidence related to the ‘Robin Hood’ approach.

### **Robin Hood objective**

From the perspective of the Robin Hood approach, the central question is whether means tested benefits are better at reducing poverty and/or inequality than universal benefits. As Whiteford suggests in relation to poverty, ‘if those countries with means tested benefit systems have much higher poverty than countries with universal benefits, then the explicit rationale for targeting would appear to collapse’.<sup>65</sup>

On the face of it, the idea that non-poor access diverts limited welfare resources from those in need seems a fairly straightforward proposition. That is, the more we spend on the non poor, the less we have available for those in most need of assistance (for example, in the form of higher benefits or additional welfare programmes). As such, the attraction of targeting derives from the fact that ‘such benefits involve a clear vertical redistribution of resources from the rich to the poor’.<sup>66</sup>

Thus, according to Goodin and Le Grand:

In egalitarian terms ... the beneficial involvement of the non-poor in the welfare state is not merely wasteful – it is actually counterproductive. The more the non-poor benefit, the less redistributive (or, hence, egalitarian) the impact of the welfare state will be.<sup>67</sup>

Further, there has long been a view among economists and social scientists that targeted programs are the most *efficient* way of reducing poverty and inequality (measured in terms of greatest impact on poverty for the least expenditure). For example, the criterion of ‘target efficiency’ (defined as the proportion of expenditure going to those below the poverty line) has historically been used as a measure of success for anti-poverty programs (particularly in the US).<sup>68</sup>

As might be expected, a number of studies have confirmed that countries employing targeted models direct a greater *proportion* of expenditure to the poor than do countries employing more encompassing models. For example, Whiteford compared the ratio of benefits received by the poorest quintile to those received by the richest quintile and found that:

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65. Whiteford, 2007, p. 6.

66. K Nelson, *Fighting poverty: comparative studies on social insurance, means-tested benefits and income redistribution*, Swedish Institute for Social Research, no. 60, 2003, p. 3.

67. R Goodin and J Le Grand, ‘Not only the poor’, in R Goodin and J Le Grand, eds, *Not only the poor. The middle classes and the welfare state*, Allen & Unwin, London, 1987, p. 215.

68. Korpi and Palme, 1998, p. 662.

... 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.<sup>69</sup>

However, this merely highlights the extent of targeting in various systems. It tells us nothing about whether targeted programs are better placed than encompassing ones to address poverty and inequality.

In fact, on the basis of comparative research, a significant number of social policy scholars have come to the opposite view: that targeting provides a poor basis for addressing poverty and inequality.<sup>70</sup> For example, Korpi and Palme found that Australia's targeted system of welfare benefits is associated with the highest levels of income inequality, with the lowest levels of income inequality occurring in those countries with more encompassing systems (universality combined with earnings-related benefits) such as Sweden, Finland and Norway.<sup>71</sup> Korpi and Palme found a similar pattern for poverty rates: the lowest rates were in the encompassing countries, with Australia having comparatively high poverty rates.<sup>72</sup> Similar results about the comparatively better performance of encompassing models compared with targeted models have been obtained in studies by Kenneth Nelson and Sheila Shaver.<sup>73</sup>

Korpi and Palme have described this situation as 'the paradox of redistribution'. That is, 'the more we target benefits at the poor only and the more concerned we are with creating equality via equal public transfers to all, the less likely we are to reduce poverty and inequality'.<sup>74</sup> Hence, in relation to Australia, they argue, 'the Australian experience indicates that targeting—excluding the better off citizens—is not highly effective in reducing poverty and inequality'.<sup>75</sup> On the basis of this, Paul Smyth argues that 'if there is an aspiration to reduce poverty and inequality then the lesson of the Australian experience appears to be that more encompassing models are to be preferred'.<sup>76</sup>

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69. Whiteford, 2006, p. 43.

70. Whiteford, 2007, p. 7.

71. Korpi and Palme, 1998, p. 674.

72. Korpi and Palme, 1998, p. 674–5.

73. Nelson, 2003, p. 30; Shaver, 1997, p. 128.

74. Korpi and Palme, 1998, pp. 681–2.

75. Korpi and Palme (1998), p. 682.

76. P Smyth, 'Australian social policy in an international context', in A McClelland and P Smyth, eds, *Social policy in Australia: understanding for action*, Oxford University Press, South Melbourne, 2006, p. 122.

One explanation for this paradox is that countries employing encompassing models have higher redistributive budgets overall than targeted models and consequently are able to provide higher benefits to the poor.<sup>77</sup> For example, according to this view, while targeted systems redistribute a greater proportion of their welfare budgets to the poor, more encompassing systems are able to make a greater impact on poverty and inequality because of their higher levels of expenditure. Thus, argues Whiteford:

In the case of [more targeted] New Zealand and Australia and to a lesser extent the United Kingdom, the systems appear to be highly efficient at reducing poverty and inequality, but their effectiveness is undercut by their relatively low levels of spending ... The [more encompassing] Nordic countries have a below average level of efficiency, but tend to spend more than other countries, and so reduce poverty and inequality to a significant extent.<sup>78</sup>

This is confirmed by Korpi and Palme who found that Australia was both among the smallest welfare states (in terms of expenditure) and among those with the poorest record of redistribution, while those countries with the largest redistributive budgets (the Netherlands and Sweden) had the highest redistributive effects.<sup>79</sup> (The question of precisely why the targeted model should be associated with lower expenditure is discussed in a later section.)

In a further twist, Whiteford has argued that ‘the OECD countries with the highest gross social spending claw back a lot of this through direct and indirect taxes’, meaning that ‘differences in net social expenditure are much less than differences in gross spending’.<sup>80</sup> As such, he has provided estimates of net redistribution to the poor (the impact of the tax and benefit systems in combination on poverty) across OECD countries. He found 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 OECD country (for which these calculations can be made)’.<sup>81</sup>

According to Whiteford’s estimates, Australia’s net generosity is not significantly greater than that of Nordic countries such as Denmark and Sweden. However, this still appears to indicate that, contrary to the ‘paradox of redistribution’, targeting can be redistributive. The main problem with this is that, while one would then expect Australia to have less poverty

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77. Korpi and Palme, 1998, pp. 675–6; Shaver, 1997, p. 128; Nelson, 2003, p. 30.

78. Whiteford, 2007, p. 11–12.

79. Korpi and Palme, 1998, p. 676.

80. Whiteford, 2006, p. 60.

81. Whiteford, 2006, p. 46.

than other OECD countries, poverty in Australia is higher than the OECD average (according to one estimate, 11.2 per cent compared to 10.4 per cent).<sup>82</sup>

Whiteford's suggested explanation for this apparent paradox is that the poorest quintile in Australia has the lowest share of earnings of any OECD country (1.6 per cent of total earnings compared to 4.5 per cent for the OECD on average).<sup>83</sup> Whiteford also notes that other countries with targeted and redistributive systems (such as the UK, Ireland, New Zealand and Belgium) also have below average earnings shares held by their poorest quintile.<sup>84</sup>

For Whiteford, the implication of this appears to be that, in the most targeted systems, while the poor receive considerable levels of redistribution, 'they remain poor because of their low share of [private] income'.<sup>85</sup> Possible explanations for this include differences in the composition of the low-income population (in Australia, many in the low-income category are pensioners and hence less likely to be employed) and the possibility that this poverty could be a result of 'behavioural responses to the benefit system'.<sup>86</sup> This could refer to responses to high effective marginal tax rates, the absence of sufficient measures to support the transition from welfare to work and so forth.<sup>87</sup>

If high effective marginal tax rates were found to have a role in the low levels of private income of Australia's poor, this would provide yet another twist in the debate about targeting and redistribution. That is, despite what appears to be a strong record for targeted systems in income redistribution, the key mechanism for targeting, means testing, could potentially be responsible for undercutting efforts at reducing poverty and inequality.

### **Piggy bank objective**

As noted above, information about the relative effectiveness of targeted welfare compared with that available to the middle class in addressing poverty and inequality is easier to come by than that which seeks to address the objective of redistribution in relation to adverse contingencies and/or transitions across the lifecycle (the piggy bank objective). This

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82. M Forster and M Mira D'Ercole, *Income distribution and poverty in OECD countries in the second half of the 1990s*, OECD social, employment and migration working paper no. 22, OECD, Paris.

83. Whiteford, 2006, p. 46.

84. Whiteford, 2006, p. 46.

85. Whiteford, 2006, p. 46.

86. Whiteford, 2006, pp. 46–47.

87. In recent years, policy effort in this area has been in the form of activity testing of pensions for groups such as people with disabilities, sole parents and widows. Given that they were introduced relatively recently, any impact of such measures would be unlikely to be captured by poverty statistics.

probably has much to do with lack of clarity or agreement about precisely what unit of measurement should be used in any evaluation of the latter.

This is complicated somewhat by the fact that expenditure related to the piggy bank objective in targeted welfare states like Australia is provided under a Robin Hood approach (that is, means tested). In such systems, levels of poverty or inequality among people in different categories (the unemployed, the disabled, the elderly and so forth) in either targeted or universal/encompassing systems might be considered to be a reasonable measure of relative effectiveness. However, comprehensive comparative data across categories is not available. There have been some attempts to compare the effectiveness of different welfare systems in addressing poverty and inequality among the aged. For example, Korpi and Palme found that gross income inequality among the elderly was highest in (targeted) Australia and lowest in more encompassing systems like Sweden and Norway (though, this may not take into account indirect taxes paid by the elderly and hence could potentially overstate the differences between the two types of system). However, in many categories (such as the disabled), such comparisons would be particularly difficult to develop due to, for example, lack of comparable data across countries.

Furthermore, others would argue that focusing exclusively on poverty and inequality misses a (perhaps the) key aspect of the piggy bank approach. That is, that rather than being simply about the redistribution of income, welfare should be seen as about enabling people to manage risks associated with a range of contingencies and transitions (for example, sickness, disability, unemployment, raising children, participating in further education) across the life course. Thus, for example, family payments can be seen as not simply compensating people for the costs associated with raising children but also as part of encouraging people to take the risks associated with choosing to do so (for example reducing/leaving paid employment). Similarly, government investments in some countries in lifelong learning (e.g. technical and further education), including through income support for those seeking to 're-skill', can be seen as assisting individuals to manage risks associated with possessing the right type of job skills. Importantly, welfare expenditures such as these have the potential to produce both private (individual, family) and public (employer, the economy) benefits.

According to this approach, the most appropriate measure of effectiveness is less likely to be about poverty and inequality than it is about more complex/rich indicators such as willingness to take risks, capacity to manage social transitions or development of a range of individual capabilities.<sup>88</sup> According to one proponent of this approach, these functions of the welfare state are 'just as relevant, (perhaps more so) for those on middle incomes as for those lower down the scale'.<sup>89</sup> Consequently, to the extent that targeting according to means is regarded as a/the appropriate means for addressing poverty (and the discussion above

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88. For an elaboration of the capabilities approach see Sen; M Nussbaum, *Frontiers of justice: disability, nationality, species membership*, Harvard University Press, Cambridge, Mass., 2006.

89. J Quiggan, *The risk society. Social democracy in an uncertain world*, Centre for Policy Development, Occasional paper no. 2, July 2007, p. 4.

indicates that the evidence is mixed), it is far less relevant when welfare is viewed in terms of the piggy bank objective. Indeed, it may be that, given the negative incentive effects associated with means testing, targeting according to income is likely to have negative effects on people's capacity to manage risks and transitions and develop capabilities. At this stage, however, comparative evidence specifically addressing this area is lacking (though, the later section on social investment does address evidence with some relationship to this area).

### **Productivity: 'churning' versus social investment**

An important theme in public policy debates is the impact of welfare on productivity and economic growth. That is, does welfare have negative or positive effects on the economy? Further, what role does *middle class* welfare play in all of this? Does non-poor access to welfare enhance/exacerbate the overall impact of welfare on productivity?

One of the main criticisms of the welfare state from the perspective of the right refers to the negative impact of welfare on the market. This is said to arise for two main reasons. First, the increased taxation and regulatory burden associated with the welfare state is said to create a *disincentive to investment*.<sup>90</sup> Second, the protection of individuals from market forces is said to create a *disincentive to work* (or at least to work as productively as one otherwise would).<sup>91</sup> Taken together, these effects are said to produce a dynamic of declining growth and increased expectations of government for welfare expenditure 'which can less and less be satisfied by the available output'.<sup>92</sup>

### **Churning**

For some critics, what are held to be the negative effects of welfare on economic growth are exacerbated when households are both recipients of welfare and tax payers simultaneously (that is, they are recipients of middle class welfare). This flow of transfers into households and taxes out of the same households is known as the 'tax-welfare churn' or 'churning'.

One of the main objections to churning relates to what are said to be the inefficiencies associated with the higher taxes required to finance middle class welfare. First, these are said

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90. C Offe, 'Some contradictions of the modern welfare state', in C Pierson and F Castles, eds, *The welfare state reader*, Polity Press, Malden, Mass., 2000, p. 69.

91. Offe, p. 69.

92. Offe, p. 69. This classical liberal perspective on welfare has been made since governments in western industrialised countries began to increase their involvement in welfare in the late 1800s and early 1900s. Nevertheless, the rise of the Keynesian economic consensus (and a range of other political and social factors) following World War II underpinned a significant expansion in welfare benefits and services leading to what we now know as the welfare state. However, changing social and economic conditions in the 1970s (including declining economic growth and high rates of unemployment), led to a resurgence in classical liberal ideas both in Australia and overseas (known variously as neo-classical liberalism, neo-liberalism or the new right).

to create work disincentives. Second, it is argued that because taxes have an efficiency cost, they ultimately reduce overall economic output (according to economist, Andrew Leigh, ‘the best recent estimate for the ‘deadweight burden’ [of taxation] in Australia is about 20 cents in the dollar’).<sup>93</sup> Thus, according to Peter Saunders (CIS), the efficiency of the welfare system and the economy could be improved through the elimination of churning:

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 put 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.<sup>94</sup>

According to Saunders, this would deliver a ‘huge boost to individual enterprise and work incentives while still ensuring everyone gets access to the basic services they need’.<sup>95</sup>

A further objection to churning refers to the idea that including middle class households in the welfare system causes them to become reliant on government, rather than provide for themselves from their own earnings. This, it has been argued, diminishes the capacity of individuals to make decisions about their own lives, potentially subjects them to high effective marginal tax rates and creates the possibility that, in future times, they may be subject to greater government intrusion into their lives.<sup>96</sup>

Criticisms of churning have been challenged on a number of grounds.<sup>97</sup> First, compared with other OECD countries, churning is low in Australia.<sup>98</sup> This is not unexpected given Australia’s high rates of means testing and the low share of taxes paid by the poor.<sup>99</sup>

Second, it is not clear that churning is as inefficient as has been suggested by its critics. For example, Korpi and Palme have argued that there is no evidence of major negative effects on the labour supply in high-tax welfare states.<sup>100</sup> They suggest that this is because:

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93. A Leigh, ‘Help the poor, and cut taxes’, *Australian financial review*, 1 November 2007.

94. P Saunders (CIS), *How increased self reliance will result in a lower burden*, Online Opinion, 15 April 2005. Note: in order to distinguish between Peter Saunders of the Centre for Independent Studies (CIS) and Peter Saunders of the Social Policy Research Centre (SPRC), this paper will refer to them as ‘Peter Saunders (CIS)’ or ‘Peter Saunders (SPRC)’, respectively.

95. P Saunders (CIS), *The \$85 billion tax/welfare churn*, Issue analysis no. 57, 7 April 2005, Centre for Independent Studies, p. 13.

96. Norton, p. 22.

97. This section summarises the main criticisms of the anti-churning argument. A more complete discussion of the issue can be found in Whiteford, 2006, pp. 47–52.

98. Whiteford, 2006, pp. 47–8.

99. Whiteford, 2006, pp. 47–8; Saunders (CIS), 2005, p. 11.

by providing earnings-related benefits and non-means tested benefits, the encompassing model generates incentives to work and also avoids poverty traps. Furthermore, if citizens find that they get significant benefits in return for their taxes, their take home pay is no longer the only basis for work incentives.<sup>101</sup>

Further, Whiteford suggests that removal of churning (along the lines proposed by Saunders) would potentially leave considerable incentive problems through higher effective marginal tax rates associated with greater targeting.<sup>102</sup>

Finally, churning may not be as irrational as its critics suggest. According to Whiteford:

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.<sup>103</sup>

For example, Whiteford suggests that an example of rational churning in Australia might be the July 2000 introduction of the goods and services tax combined with a compensation package of increased benefits and family payments. While this involved an increase in churning, it was specifically designed, he argues, to ‘increase economic efficiency while protecting low-income groups from the adverse effects of higher prices’.<sup>104</sup>

Further, middle class households may regard it as entirely rational to pool their resources with the rest of the community through governments in order to develop and maintain benefits and services that they regard as being in their (and the broader public) interest. Saunders work appears to concede the necessity of government provision of such service as defence, police, transport (he states that does not include these in his calculations of the extent of churning). Some might argue that government provision of welfare benefits (e.g. family payments) and services (education and health services) is consistent with the objectives of combining economic efficiency with fairness and equity (see following section on social investment).

Even if there is some irrationality associated with churning, it may be that this is not a matter of great concern for most people. Perhaps it is the case that, as former prime minister, John Howard, has suggested, ‘people like getting a cheque from the government’.<sup>105</sup> This can be illustrated by the fact that, although the option exists for people to take family tax benefit in

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100. Korpi and Palme, 1998, p. 682.

101. Korpi and Palme, 1998, p. 682.

102. Whiteford, 2006, pp. 50, 52.

103. Whiteford, 2006, pp. 49–50.

104. Whiteford, 2006, p. 50.

105. Quoted in M Duffy, ‘It's not just the money, it's about the love’, *Sydney morning herald*, 22 April, 2006.

the form of lower taxes, fewer than 10 per cent choose to do so (most preferring to take it as a regular cash payment).<sup>106</sup> It may be that, given the choice, people are happy for the welfare system to retain its ‘piggy bank’ role.

### **Social investment**

According to some social policy scholars, more encompassing forms of welfare are preferable to more selective forms because of the role played by welfare in creating and securing conditions necessary for productivity, efficiency and economic growth. This position represents a challenge to two key themes in debates about welfare policy: (a) the notion that welfare is either exclusively or primarily about altruism and benevolence and (b) as discussed above, the notion that welfare is inherently antithetical to (or, at the very least problematic for) markets, productivity and economic prosperity.<sup>107</sup>

Proponents of the idea of welfare as social investment turn these themes on their head by arguing for the notion of welfare as an essential prerequisite for economic prosperity. The basis of this claim is the understanding of welfare as an investment in human capital through, for example, strong education and health systems and inclusive and cohesive societies. In this view, welfare is conceived as an investment aimed at overcoming what are essentially problems of poor human capital development (poor education and health, social marginalisation) that themselves place limits on productivity and economic growth.<sup>108</sup>

Social policy scholar, Paul Smyth, has illustrated this position through a discussion of Esping-Anderson’s recent work on the importance of investment in children:

Esping-Anderson writes of the way in which citizens’ life chances are powerfully overdetermined by their social origins. Focusing on the long-term educational importance of cognitive skills, which are for the most part developed prior to formal learning, he argues that it is necessary to have, alongside a well-designed school system, an absence of child poverty through the guarantee of adequate income to families with children, as well as the provision of universal, high-quality childcare. In the knowledge economy, he writes, we simply cannot afford social exclusion.<sup>109</sup>

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106. R Gittins, ‘Don’t let churn row bamboozle’, *Sydney morning herald*, 23 August 2008.

107. This latter view of welfare is a key theme on both the left and right of politics. As can be seen from the earlier discussion of Esping-Anderson’s classification of welfare states, the notion that welfare enables people to exist outside of markets is an important theme within the social democratic approach to welfare. On the other hand, as discussed above, the notion that welfare is inherently detrimental to economic productivity is a central tenet of classical (or neo) liberal thought.

108. P Aighon and J Williamson, *Growth, inequality and globalisation*, Cambridge University Press, Cambridge, 1998. See also Sen.

109. P Smyth, ‘Closing the gap? The role of wage, welfare and industry policy in promoting social inclusion’ *Journal of industrial relations*, vol. 50, no. 4, 2008, pp. 658–9.

Thus, according to proponents of the social investment approach, welfare is not about stifling markets but rather ‘providing a basis for market-steering which results in better and fairer market transactions’.<sup>110</sup> Consequently, it is argued, there is no inherent conflict between equality and efficiency.<sup>111</sup>

Smyth has argued that the social investment approach during the late nineteenth and early twentieth centuries played a key role in the development of the Australian economy.<sup>112</sup> Rather than remain a largely agrarian society with a small population and low wage service class, he argues, Australia ‘chose to use its land-based wealth to steer its economic development towards the new industrial sector and so develop a more diverse, higher-wage economy’.<sup>113</sup> At this time, the state played a bigger role in the Australian economy than in any other country.<sup>114</sup> This investment included both physical infrastructure (roads, ports and railways) and social infrastructure (state secondary and technical education, public health and slum clearance).<sup>115</sup>

According to Smyth, ‘governments’ task was conceived in terms of equipping individuals to participate effectively in the market’.<sup>116</sup> However, throughout the twentieth century this approach was successfully challenged by various layers of alternative approaches, culminating in the free market approach that came to dominate the international policy agenda from the 1970s.<sup>117</sup> Recent years have seen a resurgence of the social investment approach through ideas and policies associated with the ‘third way’—particularly in the UK.

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110. J Browne, S Deakin, and F Wilkinson, ‘Capabilities, social rights and European market integration’, in R Salais and R Villeneuve, eds, *Europe and the politics of capabilities*, Cambridge University Press, Cambridge, pp. 205–21.

111. O Kangas and J Palme, *Social policy and economic development in the Nordic countries*, Palgrave MacMillan, London, 2005.

112. Smyth, 2008, p. 651.

113. Smyth, 2008, p. 651.

114. K Tsokhas, *Making a nation state*, Melbourne University Press, Carlton, 2001.

115. The economist, Amartya Sen, has written of the importance of investment in social infrastructure in developing countries in contrast to the belief that human development is a luxury affordable only to rich countries. He has argued that ‘perhaps the most important impact of the type of success that the East Asian economies have recently had (beginning with Japan—decades earlier) is the total undermining of that implicit prejudice. These economies went comparatively early for massive expansion of education, and later also of health care, and this they did, in many cases, *before* they broke the restraints of general poverty. And despite the financial turmoil that some of these economies have recently experienced, their overall achievements over the decades have typically been quite remarkable. As far as human resources are concerned, they have reaped as they have sown ... Human development is first and foremost an ally of the poor, rather than of the rich and affluent’. Sen, pp. 143–4.

116. Smyth, 2008, p. 652.

117. Smyth, 2008, p. 652.

In Australia, moves towards a social investment approach have been more tentative than in countries such as the UK. The clearest Australian manifestation of the social investment approach has been through the Council of Australian Governments (COAG) 2006 proposal for a third wave of national economic reform based around a major new investment in human capital.<sup>118</sup>

Importantly, from the perspective of this paper, proponents of the social investment approach have argued that welfare systems that are inclusive of the middle classes make it possible to combine high rates of growth with social equity. For example, the economist, Peter Lindert's 2004 study of social expenditure and economic growth in OECD countries found an association between strong growth and universalist approaches to welfare. Lindert found that 'high budget welfare states have achieved much the same growth [as lower-spending countries] with greater equality'.<sup>119</sup> Similar conclusions have been reached in studies by economists Harold Wilensky and Anthony Atkinson.<sup>120</sup>

Smyth suggests that an important lesson from Lindert's work is 'the way tax and transfer systems can be designed to avoid compromising growth; and in particular the way in which universal systems can foster growth better than strictly means tested ones'.<sup>121</sup>

Lindert's explanation for this is that it probably relates to the politics of welfare. That is, he argues that for social democratic welfare states, universal welfare entitlements have created both the political necessity and opportunity for 'pro-growth tax mixes':

It is easier to pass pro-growth, relatively regressive changes in the tax structure if the left opposition can be calmed by a commitment to spend tax proceeds on universalist safety net transfers. Such political transfers seem to have tied the postwar emergence of the welfare state to the rise of broad consumption taxes rather than taxes aimed at businesses and the wealthy. By contrast, conservatives in low-budget countries like the United States have lacked such protective political clothing for their preferred tax reforms. Having rejected the welfare state with its broad transfers and public health care, conservatives have looked like

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118. P Smyth, *Social investment in human capital. Revisioning Australian social policy*, social policy working paper no. 8, Centre for Public Policy, September 2007; D Perkins, L Nelms and P Smyth, *Beyond neo-liberalism: the social investment state?*, social policy working paper no. 3, Centre for Public Policy, September 2004.

119. P Lindert, *Growing public: social spending and economic growth since the eighteenth century*, vol. 1, Cambridge University Press, Cambridge, 2004, p. 307.

120. H Wilensky, 'Trade-offs in public finance: comparing the well-being of big spenders and lean spenders', *International political science review*, vol. 27, no. 4, 2006, pp. 333–58; A Atkinson, *The welfare state and economic performance*, Discussion paper, London School of Economics, London, 1995.

121. Smyth, 2007, p. 7.

blatant redistributive grabbers when they have called for consumption taxes and tax relief for capitalists.<sup>122</sup>

There are several points that can be raised in relation to the proposition that universal welfare is strongly associated with economic growth. First, Lindert's political explanation for why this should be the case, while plausible, appears to be mainly speculative. This suggests the need for more research into what specifically it is about universalist systems that makes them as good (or better) at achieving growth than systems which employ means testing. Is the decisive factor actually whether the system is universal or selective or are other elements at play?

Second, evidence of the benefits associated with universal systems notwithstanding, the recent resurgence of the 'welfare as social investment' approach (particularly in the form of UK New Labour's third way) has involved a strong emphasis on targeting of particular groups thought to offer the best returns on investment (e.g. education, childcare, health). Some have suggested that this has led to a reduced focus on other groups and policies. For example, Jenson and Saint Martin have suggested that the social investment approach have led policy makers question the cost-effectiveness of 'second chance' interventions for adults.<sup>123</sup> They have also suggested that the elderly are likely to be disadvantaged under this approach.<sup>124</sup>

Arguably, this is the logical consequence of reordering of welfare along productivist lines—that is, conceiving of welfare in (instrumentalist) terms of serving the economy rather than in terms of social rights. However, some suggest that this is not necessarily the case and that a social investment approach informed by values (as Smyth puts it, 'new social criteria for investment decisions') can enable the pursuit of economic prosperity in combination with people's current and future welfare needs.<sup>125</sup>

Finally, the social investment is relatively silent on the question of the environment and appears to assume that the only relevant impediments to growth are social. Arguably, though, there are reasonable grounds to suggest that economic and social policy need to be rethought in the light of environmental risks such as climate change. Smyth argues that the social investment approach implies the possibility of integrating economic and social policy in a mutually beneficial way. Perhaps an integration of economic, social and environmental policy is equally crucial.

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122. Lindert, p. 36.

123. J Jenson and D Saint-Martin, 'New routes to social cohesion? Citizenship and the social investment state', *Canadian journal of sociology*, vol. 28, no. 1, 2003, pp. 92–3.

124. Jenson and Saint Martin, page?

125. For example, Smyth (2008, p. 659) suggests that the 'capabilities approach' to social policy developed by Amartya Sen and Martha Nussbaum is a possible source for such a set of values.

## **The politics of welfare: the middle class inclusion thesis**

One of the main arguments used for including the non poor in the welfare state relates to what Goodin and Le Grand have called the ‘sharp elbows of the middle classes’:

The idea here is that if the middle classes benefit from programmes, then they will use their not inconsiderable political skills to obtain more resources for those programmes or to defend them in periods of decline. As a result, the welfare programmes will be better funded—and the poor better off in consequence—than they would have been had the middle classes not been beneficially involved.<sup>126</sup>

Thus, as Peter Saunders from the Social Policy Research Centre argues, ‘broadly based programs’ have an important role in ‘underpinning the support of the middle classes’:

... without which the welfare state would founder politically. Far from being its main weakness, ‘middle class welfare’ is the lifeblood of the welfare state.<sup>127</sup>

For advocates of this position, sometimes known as the ‘middle class inclusion thesis’, systems that restrict welfare services and benefits to the poor are much more vulnerable to retrenchment (that is, being eroded or withdrawn) and likely to be inadequate compared to those to which all citizens may participate in by right.<sup>128</sup> In other words, ‘if the welfare state includes the middle class, the political possibilities are greater for providing generous social protection for the less fortunate’.<sup>129</sup>

The main evidence in favour of there being a ‘middle class inclusion effect’ is that, as discussed above, more encompassing welfare states have larger redistributive budgets and provide more generous benefits than those based around basic security and targeting. That is, as Shaver puts it, ‘benefits earmarked for the poor are likely to be poor benefits’.<sup>130</sup>

There are a number of explanations for how middle class inclusion operates to produce support for generosity for the poor. For example, in his history of the European welfare state, Peter Baldwin has described this phenomenon in terms of a ‘trickle down’ effect resulting from the middle classes ensuring that their interests were protected through a generous social

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126. Goodin and J. Le Grand, p. 210.

127. P Saunders (SPRC), *The ends and means of welfare: coping with economic and social change in Australia*, Cambridge University Press, Cambridge, England, 2002, p. 59.

128. K Nelson, ‘Mechanisms of poverty alleviation: anti-poverty effects of non-means-tested and means-tested benefits in five welfare states’, *Journal of European social policy*, vol. 14, no. 4, 2004, p. 375.

129. Nelson, 2004, p. 375.

130. Shaver, 1997, p. 128.

insurance system, which then opened the way for the poor to benefit.<sup>131</sup> Korpi and Palme argue that more encompassing welfare state arrangements act as ‘intervening variables’ creating the bases for cross-class coalitions:

By giving basic security to everybody and by offering clearly earnings-related benefits to all economically active individuals, in contrast to the targeted and basic security models, the encompassing model brings low-income groups as well as the better-off citizens within the same institutional structures ... The encompassing institutional model can thus be expected to have the most favourable outcomes in terms of the formation of cross-class coalitions which include manual workers as well as the middle classes. By providing sufficiently high benefits for high-income groups so as not to push them to exit, in the context of encompassing institutions the voice of the better-off citizens helps not only themselves but low-income groups also.<sup>132</sup>

Thus, the idea common to most explanations of why middle-class inclusion in the welfare state results in more generous benefits to the poor relates to the self-interest (rather than altruism) of the middle classes.

One criticism made of the middle class inclusion thesis is that the middle classes will tend to reserve their support for the welfare state for those parts of it from which they are most likely to directly benefit. For example, in case studies examining the fate of welfare programs under the Thatcher and Reagan Governments, Goodin and Le Grand found that in Britain, the Thatcher Government had been ‘significantly more generous in its treatment of social programmes characterized by predominantly middle-class beneficiaries than in its treatment of programmes used predominantly by the poor’. In the US, non-means tested social insurance programmes ‘continued to flourish under the Reagan administration’s cutbacks, while the means test for social assistance programmes targeted tightly on the poor [grew] progressively meaner’.<sup>133</sup>

Similarly, a study by Kenneth Nelson found that vulnerability of means tested programs to retrenchment (that is, cuts in the form of reduced benefits and/or abolition of programs) is greater in the more extensive welfare states (those with encompassing social insurance systems), than it is in countries that rely primarily on basic security forms of social insurance

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131. P Baldwin, *The politics of social solidarity. Class bases of the European welfare state 1875-1975*, Cambridge University Press, Cambridge, 1990, p. 298. Baldwin argues that ‘where the state was excluded from or restricted in the management of personal risk, they were left to the last resort of personal assistance. Where the state became the main insurance broker of the bourgeoisie, in contrast, the disadvantaged gained from clinging to the coattails of the favoured. The middle classes arranged things first and foremost for themselves, the unfortunate were the beneficiaries of a comparatively successful tickle-down’.

132. Korpi and Palme, 2004, p. 163.

133. Goodin and Le Grand, pp. 203–04.

or that place greater emphasis on private forms of income protection (for example, the US and Australia).<sup>134</sup>

While Goodin and Le Grand take this as evidence against relying on the middle class as a guarantor of welfare generosity, others see it as evidence for the need of greater middle-class inclusion. As Baldwin argues:

... social legislation aimed also at the middle classes has been more stable and firmly supported than measures reserved for the needy. Even—perhaps especially—the cutbacks of the 1970s confirm the point here, having hit most harshly those programs and policies addressed particularly or only to the poor, while largely sparing middle-class entitlements. In the long run, the unfortunate have gained most from those welfare states anchored in the interests and affections of the bourgeoisie.<sup>135</sup>

One problem with the argument that universal/encompassing models are a better guarantee of public support for welfare is that, the attempts above notwithstanding, it is very difficult to demonstrate a causal relationship between the type of welfare institution and the attitudes and behaviours of specific people. Korpi and Palme themselves acknowledge this problem when they note the lack of direct causal (as opposed to associational) evidence for their hypothesis:

The empirical testing of macro-micro links between institutions and the formations of interests and coalitions provides a major challenge to social scientists. So far, we lack the comparative micro-data necessary for opening up this macro-micro blackbox.<sup>136</sup>

However, in support of their hypothesis Korpi and Palme do provide evidence that the German social insurance model, comprising separate schemes for manual workers and salaried employees (under which the latter are substantially privileged), ‘has significantly contributed to the cementation of the white/blue collar divide in Germany’.<sup>137</sup> In other words, the existence of separate schemes has militated against the possibility for cross-class coalitions. Several authors have also referred to survey evidence which indicates universal/encompassing models of welfare receive considerably more support among citizens than targeted models.<sup>138</sup> However, other studies have found no variation in support across welfare state types.<sup>139</sup> In any event, indications of support for a particular welfare model do

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134. K Nelson, ‘Universalism versus targeting: the vulnerability of social insurance and means-tested minimum income protection in 18 countries’, 1990-2002’, *International social security review*, no. 60, 2007, pp. 54–5.

135. Baldwin, 1990, p. 298.

136. Korpi and Palme, 2004, p. 172. See also Nelson, 2004, p. 375.

137. Korpi and Palme, 2004, p. 172.

138. Nelson, 2004, p. 375; Korpi and Palme, 2004, p. 172.

139. J Gelissen, ‘Popular support for institutionalised solidarity: a comparison between European welfare states’, *International journal of social welfare*, 9, 2000, p. 285.

not really assist us in understanding whether that model is a decisive factor in producing attitudes and behaviours towards the welfare state and/or towards the poor.

A possible alternative explanation for the ‘middle class inclusion effect’ could be that there is a universalist/encompassing approach to welfare because there is a general socio-cultural disposition in favour of welfare expenditure, rather than the other way around. British sociologist, Anthony Giddens, suggests that this might be the case when he argues that ‘Nordic egalitarianism has historical and cultural roots rather than being only the product of the universalist welfare state’.<sup>140</sup> There is, he argues, ‘wider public acceptance of higher taxation than in most Western countries’.<sup>141</sup>

It is also important to note that, while there is evidence that people will tend to support social institutions from which they directly benefit, there is also evidence of the opposite: that people will support institutions despite there being no obvious or immediate benefit to them directly (for example, bushfire services, the police). Further, there is also evidence that people will support social institutions for moral reasons (for example, blood donation).

None of this is to argue that the middle-class inclusion thesis is wrong but rather that (a)it is difficult to prove and (b)the picture is likely to be more complex than simple causality between type of welfare system and level of support for welfare generosity.

## **Social cohesion**

The idea that welfare is positively associated with social cohesion has long been a prominent feature of social policy debates. Broadly speaking, social cohesion can be said to refer to the process of minimising social disparities and avoiding conflict and polarisation.<sup>142</sup> In other words, it is strongly associated with values and objectives such as equality, inclusiveness and community. Social cohesion is therefore closely related to (and often used interchangeably with) concepts such as solidarity, fellow-feeling, unity, social connectedness, social stability, social integration and social inclusion.

The term social cohesion (and its various related terms) and the ways in which it has been used have frequently been the subject of criticism.<sup>143</sup> White has described it as a quasi-

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140. A Giddens, ‘Positive welfare’, in C Pierson and F Castles, eds, *The welfare state reader*, Polity Press, Malden, Mass., 2000, p. 371.

141. Giddens, p. 371.

142. Council of Europe, *Security through social cohesion: proposals for a new socioeconomic governance*, Social Cohesion Development Division with the support of the Integrated Project, ‘Responses to violence in everyday life in a democratic society’, Trends in social cohesion, no. 10, p. 10. According to the Council of Europe, ‘a cohesive society is a mutually supportive community of free individuals pursuing these common goals by democratic means’.

143. D White, ‘Social policy and solidarity, orphans of the new model of social cohesion’, *Canadian journal of sociology*, vol. 28, no. 1, 2003, p. 55; Goodin and Le Grand, p. 12.

concept whose conceptual precision seems to be inversely correlated with [its] political usefulness'.<sup>144</sup> Nevertheless, it has long been a key concept in the social sciences, including studies of social policy. Indeed, according to some accounts, the development of the welfare state can be understood as a series of political responses to social cohesion. According to White:

England was the first country to adopt a clearly *social* policy, in the form of the poor laws (1563, 1601, 1834), in which the crown established and enforced the first national program for the management of poverty through redistribution. The Poor Laws aimed to protect the landed gentry and an emerging bourgeois society from the so-called "dangerous classes", by physically maintaining and containing the latter in a manner that would enforce obedience to the new norms of labour market and self-responsibility. Yet it was not in liberal England, but rather, in conservative Germany that the first welfare state is considered to have been born. The most advanced industrial nation in the 19<sup>th</sup> century, it was also the most immediately threatened by the potential for class war. Here, in the 1860's, Bismarck introduced a series of social insurance programs which, for the first time, institutionalized a degree of security for workers through cross-class solidarity, to be enforced by government.<sup>145</sup>

Further, White argues that contemporary welfare states 'are the direct descendants of these different, early strategies for managing volatile market societies, as well as more modern strategies, based on social democratic traditions'.<sup>146</sup>

As can be seen from the above, the basic argument for a positive association between welfare and social cohesion is that the former contributes to the latter by enhancing the capacity of the society to ensure the well-being and sense of security of individuals or groups. However, the social policy literature contains a range of propositions about the precise mechanism(s) according to which welfare promotes social cohesion, including:

- by reducing social inequality, exclusion and insecurity, welfare reduces the possibilities for class resentment and social conflict.<sup>147</sup> In other words, conflict is less likely in societies in which the broadest number of people consider that their basic material, social and various other needs have been met
- by reducing the social distance between citizens, welfare creates a shared space of identity and status. This is considered to enhance possibilities for the development of social unity and affinity. In some cases, this can be expressed in the form of national identity (for example, when comparisons are made with the less generous welfare states of other

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144. White, p. 55.

145. White, p. 55

146. White, p. 55–56.

147. J. Barbalet, 'A macro sociology of emotion: class resentment', *Sociological theory*, vol. 10, no. 2, 1992, p. 154.

countries).<sup>148</sup> According to some accounts, universal welfare is better placed than targeted welfare to achieve social cohesion because it involves citizens from across the society belonging to the same systems, programs and processes.<sup>149</sup> For example, Titmuss strongly emphasised the role of the universal welfare state in cultivating people's altruistic feelings and institutionalising a deeper sense of community and mutual care<sup>150</sup>

- similarly, some argue that welfare enhances the possibilities for the formation of political alliances and solidarity among interest groups and social classes. As discussed in the previous section, some argue that universal/encompassing welfare states are more conducive to cross-class solidarity than targeted ones as a result of the middle class inclusion effect. That is, universal/encompassing welfare states encourage cross-class cooperation because it is in the interest of all who participate in the welfare state to do so.

While these propositions are categorised separately, they are not necessarily mutually exclusive. For example, while it is often presumed in welfare and other policy debates that people are motivated *either* by altruism *or* self-interest, others have suggested the need to assume that people will have multiple, co-existing impulses and considerations (which may include *both* altruism and self-interest).<sup>151</sup>

The key question for this paper is whether possibilities for social cohesion are enhanced (or perhaps even diminished) by *middle class* participation in the welfare state. As noted above, a range of social policy scholars, from Titmuss to Korpi and Palme, consider universal/encompassing approaches to welfare to be more likely than targeted ones to achieve social cohesion. On the other hand, some have suggested that targeted welfare can also play an important role in strengthening social cohesion. For example, T.H. Marshall argued that 'a total scheme is less specifically class abating in a purely economic sense than a limited one, and social insurance is less so than a means tested service'.<sup>152</sup> Further, White has suggested that in targeted approaches, 'the right to social assistance is available to any resident who

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148. For example, in relation to Canada, Deena White has noted that 'in comparison with the far less interventionist stance taken by the US federal government, the relatively well-developed Canadian welfare state came to be seen as emblematic of what distinguished Canadians from their more assertively individualistic neighbours south of the border. This played no small role in tying the superior social rights enjoyed by Canadian citizens, to a proud Canadian identity'. White, p. 57.

149. Shaver, p. 11.

150. R Titmuss, 'Universalism versus selection', in C Pierson and F Castles (eds.), *The welfare state reader*, Polity Press, Malden, Mass., 2000; See also R Lowe, *The welfare state in Britain since 1945*, Macmillan, London, 1993, p. 21.

151. A Bergmark, M Thorslund and E Lindberg, 'Beyond benevolence—solidarity and welfare state transition in Sweden', *International journal of social welfare*, no. 9, 2000, p. 240.

152. T Marshall, *Citizenship and social class*, Cambridge University Press, Cambridge, 1950, p. 55.

meets established criteria of need, thus laying a basis for a shared sense of social security and solidarity amongst all citizens, should calamity befall any one of them'.<sup>153</sup>

The main problem in evaluating the relative claims of universality and targeting in promoting social cohesion is the absence of specific studies comparing different welfare approaches in relation to this objective. This could possibly be a result of the conceptual imprecision discussed above. That is, the specific evidence any such study would be looking for is not entirely clear (the extent of social conflicts?, attitudes across the society to people in different classes, subclasses, ethnic groups?). While, as discussed above, some have suggested that public opinion about the welfare state might be used as evidence for cross-class solidarity in universal/encompassing systems, the evidence for this is mixed. Further, even if there was strong evidence for greater support for welfare in universal/encompassing systems, we would still need to ask precisely what this is measuring. Is the particular model of welfare the only or decisive factor or should we be looking to other explanations such as differences in culture and/or the social, political and economic organisation of the welfare state.<sup>154</sup>

A further (infrequently acknowledged) point to be made in relation to debates about the relationship between welfare and social cohesion is there are competing notions of precisely what kind of society is the desired endpoint. What one considers to be 'the good society' will tend to differ according to one's philosophical and/or political point of view (conservative, liberal, social democratic and so forth). In other words, while notions such as social unity are often presented in political debates as if they are above politics, they are inextricably linked with competing notions of the good society (that is, they are inherently political).<sup>155</sup> Governments will tend to use different kinds of welfare expenditure to advance the notions of the good society to which they subscribe. Further, some attempts to advance particular notions of community at the expense of others might well be considered as socially divisive, rather than advancing social solidarity. Some have argued that this is one effect of welfare reforms inspired by the concept of 'mutual obligation' over the last decade in many western countries—that is, the division of welfare recipients into those deserving of more or less unconditional support (the aged, families with children) and those to whom conditions (such as activity tests) are applied.<sup>156</sup>

On a related note, it has been argued that welfare reforms in recent years, in addition to promoting the interests of particular categories of citizens over others, have eroded the basis

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153. White, p. 52.

154. Gelissen, p. 299.

155. On this, it is worth noting the various critiques from both the libertarian and (what might be called) 'radical' or 'emancipatory' point of view of the negative consequences for social cohesion arising from the paternalistic and intrusive aspects of the welfare state. For a brief discussion of these, see for example, P Mendes, pp. 2–3; Gelissen, p. 285.

156. Castles, 2001; S Shaver, 'Australian welfare reform: from citizenship to social engineering', *Australian journal of social issues*, vol. 36, no. 4, 2001, p. 280.

for social cohesion by emphasising the role of the individual over that of the social. According to White:

Traditional welfare state policies, at their best, constructed solidarity by placing all citizens on equal structural footing with respect to a spectrum of social rights, providing a shared sense of social security. They supported the view that market societies posed multiple risks to all citizens, risks that the state could mitigate through the techniques of social policy ... New policies, in contrast, locate risk in the individual: in his or her levels of, and capacity to deploy, human and social capital. They support the view that a citizen's ultimate place in the multidimensional hierarchy of income, education, skills, health and so on, depends on what he or she does with opportunities, however meagre these may be.<sup>157</sup>

Thus, according to this view, the underlying notion of citizenship reflected in welfare state policies is central to understanding the relationship between welfare system type and social cohesion. This may include questions about whether the middle class participates or not but equally it may include additional questions such as whether a given system ultimately locates the 'welfare problem' in the actions of individuals or in social factors.<sup>158</sup>

## **Discussion: implications for the Australian debate**

As noted above, understanding the possible implications for Australia from international debates about welfare policy is made complex by the different kinds of welfare regimes and programs prevailing in different countries. Further, while much of the debate and evidence outlined above refers to comparisons between different welfare state types (universal/encompassing, targeted) at the macro level, the Australian debate about middle class welfare has tended (at least in recent years) to focus on whether particular welfare *programs* should be means tested or available to all.

A related issue is that a policy change in the direction of either means testing or universality does not necessarily imply a move by a given government/welfare state in the direction of a particular approach to welfare at the macro level. For example, one of the criticisms generally made about the (at present) universally-available private health insurance rebate (and other private health insurances incentives) in Australia is that it forms part of an attempt to erode the universal basis of Medicare. It is said to do this by constructing the public health system as an essentially residual, safety net system and the private system as that used by responsible Australians seeking to take the pressure off public services.<sup>159</sup> With these caveats in mind, this section attempts to briefly sketch some of the possible implications for Australia of the debate and evidence discussed in the previous section.

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157. White, p. 72.

158. White, p. 72.

159. See, for example, A Elliot, 'The best friend Medicare ever had?': policy narratives and changes in Coalition health policy', *Health sociology review*, vol. 15, no. 2, 2006.

The various **technical problems** associated with means testing suggest, at the very least, the need for careful design (and, where necessary, redesign) of welfare programs. Given the nature of the debate, Australia is likely to remain the most means tested of all welfare states for the foreseeable future. Further, continuing pressure on budgets is likely to lead to calls for means testing in other areas such as health and education. However, the possibility that means testing can have negative consequences for the very people it is intended to assist (for example, through ‘poverty traps’ associated with high effective marginal tax rates) does not feature prominently in Australian debates about middle class welfare.

It is interesting to note that even authors as strongly opposed to middle class welfare as Goodin and Le Grand have described Australia’s attachment to means testing as ‘just plain perverse’, given the difficulties associated with finding the ‘Perfect Formula’ for restricting welfare to the poor.<sup>160</sup> While this may overstate matters, it is reasonable to suggest that a greater appreciation of the problems associated with means testing would provide greater balance to the Australian debate. Arguably, this is an important objective given the increasing rate of unemployment associated with the global economic crisis. To this end, as noted above, Julian Disney has suggested making adjustments to the current means testing regime for Newstart Allowance.

On the matter of **redistribution**, comparative studies indicate that welfare states with the highest levels of middle class welfare perform better than those with low levels in reducing poverty and inequality (the **Robin Hood** objectives of welfare), though the precise reasons for this remain unclear. As discussed above, Whiteford has shown that the common explanation, greater middle class support for generosity for the poor in those systems in which the middle class are participants, is undermined by the fact that, once taxes are taken into account, transfers to the poor are not substantially greater in universal/encompassing systems than they are in selective systems. However, this does not alter the fact that poverty rates are higher in selective countries than those favouring universalist/encompassing approaches—and that one possible explanation for this is that this poverty could be a result of behavioural responses to the benefit system (that is, ‘poverty traps’ associated with means testing). This challenges the assumption at the heart of much of the debate about middle class welfare in Australia that excluding the middle class enables more resources to be directed at alleviating poverty and inequality.

As discussed above, comparative data about the comparative performance of selective versus universal/encompassing systems in relation to the **piggy bank** objective of welfare is scarce. Whether one considers middle class welfare in this area to be desirable will largely depend on whether one takes a narrow or broad view of the role of welfare. For example, if, family payments are seen simply as compensating people for the costs associated with raising children, one might argue that it makes sense to restrict such compensation to those on the lowest incomes. On the other hand, if such payments are seen as part of *encouraging* people to take the risks associated with having children (for example, reducing/leaving paid

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160. Goodin and Le Grand, p. 207.

employment), one could argue that it would be rational to include people on middle incomes (and at a level that makes taking such risks sufficiently attractive).

A similar point can be made in relation to health. A narrow approach would restrict assistance for the sick to those on low incomes, while a broader approach (the approach that underpins Australia's Medicare system) might seek to establish arrangements that did not require people to become poor in order to receive assistance (on the grounds, for example, that such disruptions are not conducive to individual or broader socio-economic security).

This is an important area for discussion given that much of the recent controversy in the middle class welfare debate has been in areas related to the piggy bank objective (for example, family payments, pensions/superannuation). While some would argue that recent policies in this area have been poorly designed or built on unfair foundations, at least some of this controversy may have been avoided if it had been possible to have a clearer public debate about the choices involved (as opposed to 'the politics of envy' versus 'welfare for the rich').

Further, despite arguments suggesting a connection between welfare and poor economic **productivity**, there is comparative evidence showing that high taxing universal/encompassing welfare states have been able to achieve high rates of economic growth combined with social equity. In other words, on a broad systemic level, the evidence indicates that middle class welfare does not create incentive problems and hence is not related to poor productivity outcomes. As discussed above, some argue that, to the contrary, substantial and broad state investment in human capital (social investment) is essential for economic recovery and future economic development. In Australia, as in other countries seeking to address the global economic crisis, the state has increasingly taken on the role of investing in physical infrastructure in order to stimulate the economy. Those favouring a social investment approach would argue that similar investments need to occur in human capital (for example, in training for 'green jobs', investment in children, particularly in early childhood) in order to ensure a sustainable economic recovery. Nonetheless, questions of values remain important. At this critical juncture, do Australians want an expanded role for the state or do they want state intervention to remain at its current (relatively minimal) level? As Smyth has argued, a strong move in this direction would involve an historical change from the Australian Way of 'building up the public infrastructure to exercise real freedom, but not constraining everyone within a universal welfare state'.<sup>161</sup>

Further, evidence indicates that middle class welfare is associated with greater generosity in the level of benefits provided overall and greater resistance to retrenchment (that is, erosion in the level of benefits and/or abolition altogether). The most widely accepted explanation for this is the middle class inclusion thesis: put simply, the middle class is more likely to support welfare generosity to the poor if they themselves believe the welfare state to central to their interests. While this paper has argued that, given the lack of specific causal evidence, there are problems with assuming that the type of welfare state (selective or

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161. Smyth, 2008, p. 660.

universal/encompassing) is the only relevant factor in welfare state generosity, the association overall appears to be a strong one (and is relatively uncontested). For those seeking to institutionalise broad support for the welfare state overall (including generosity to the poor) or even particular programs, one lesson from this is that middle class support is likely to be a crucial ingredient in achieving this objective. The institutionalisation of Medicare in Australia is probably the most significant local example.

On the other hand, the fact that programs accessible by the middle class tend to be resistant to retrenchment suggests that some caution should be applied by policy makers and others when considering whether or not a program should be available universally. As Norton has argued in relation to the expansion of middle class welfare under the Howard Government, ‘when generous welfare payments reach deep into the middle class, covering families living in the marginal seats that decide federal elections, it would be a very brave government that cut them’.<sup>162</sup> While the second Rudd Budget did include a relatively significant expansion of means testing, it is important to look at this in the context of the extraordinary budgetary circumstances prevailing as a result of the global economic crisis.

Finally, while an association between welfare inclusive of the middle class and **social cohesion** has long been asserted, the lack of specific comparative evidence on this matter makes it difficult to draw firm conclusions. Some would argue that Medicare provides a good example of a universal social policy enhancing social cohesion, given the widespread support it has throughout the community and the sense in which it has become, for many people, identified with the Australian notion of a ‘fair go for all’. Indeed, for many people, the existence of Medicare has become a source of national pride—a symbol of Australia’s commitment to egalitarianism and community to be contrasted with, for example, ‘US-style health care’.

There is an argument, though, that that universal access does not necessarily have to imply universal *free* access. Drawing on an argument first advanced by Crosland in the 1950s, Goodin and Le Grand have suggested that ‘it is one thing not to means test access to a service; it is quite another not to use means tests to charge those who can afford to pay for their usage of those universally available services’.<sup>163</sup> The difficulty, from a technical point of view, would be in devising a combination of tests and charges that did not cause people to avoid using necessary services.<sup>164</sup>

McAuley and Menadue made this argument in a 2007 paper proposing health reforms in Australia based around a ‘restored universalism’:

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162. Norton, p. 22.

163. Goodin and Le Grand, p. 13

164. One problem with co-payments is that they have the potential to cause people to avoid using necessary health care such as PBS medicines or GP services through Medicare.

“Universalism” means one system accessible to all. As citizens we should all use the same health care system. Poor and rich should have access to the same health care services from the same providers. (This contrasts with the present government policy of encouraging a segregated two tier system.) A universal system is not necessarily a free system; the poor and rich may pay different amounts to have access to that universal system, but the well-off and the poor should not have separate providers (the “charity ward” notion of health care). All should share the one, high quality system.<sup>165</sup>

The authors go on to suggest that ‘co-payments, if well-structured, can help people make better choices, and they can provide some relief to public budgets’.<sup>166</sup> Given that such a system would be based around universal access to the same services, it is at least *possible* that Medicare could achieve the same impact on social cohesion, though in a way that recognised the different capacity of people to pay (and hence was more redistributive in its overall impact).

Further, others might question whether the means testing of most of Australia’s welfare benefits, in any tangible way, diminishes social cohesion. Perhaps it is enough for people to know that the welfare system is available to them should they ever need to access it. According to Shaver, ‘although not fully universal, the social protection [Australian welfare benefits] have afforded has been sufficient to establish a foundation of equality in which all citizens are able to participate in social, economic and political life’.<sup>167</sup> Would social cohesion be significantly enhanced by universalising programs such as the aged pension and how would we quantify the difference?

On a final note, arguably the most significant factor for social cohesion (particularly, if we take this term to have some relationship with the term social inclusion) in recent years has been not so much the extent of means testing but the differential treatment of welfare recipients in different categories. That is, tightened conditionality for some categories such as the unemployed and single parents, at the same time as greater generosity in terms of benefits and relaxation of means testing for others such as families with children and the aged.

## **Conclusion**

The various cuts to middle class welfare announced over the previous two budgets do not appear to amount to a significant change in direction in the welfare area by the government. Rather, they are more likely to be a reaction to increased budgetary constraints and the sense that the previous government went too far with middle class welfare (at least, in some areas).

Nevertheless, the emergence of the global economic crisis and associated social upheaval (particularly in the form of high unemployment) is likely to give rise to increasing debate

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165. McAuley and Menadue, p. 11.

166. McAuley and Menadue, p. 17.

167. Shaver, 2001, p. 280.

about the appropriate shape and extent of Australia's welfare arrangements. Given the dictum that 'one should never let a good crisis go to waste', some will take the opportunity to press for fundamental changes in the direction of either more encompassing forms of welfare or a more streamlined (and, they would argue, sustainable approach) guided more strictly by the objective of assisting those most in need.

This paper has highlighted evidence suggesting that, should the Australian Government be interested in fundamental reform, there are a number of potential benefits associated with including the middle class in the welfare system. It is reasonably clear that welfare systems that have high levels of middle class involvement are associated with high levels of redistribution, productivity and support for welfare. Some also argue that such systems can also be associated with high levels of social cohesion (though comparative evidence is lacking). Similarly, as argued above, targeting through means testing is not necessarily the panacea that many suggest it to be (particularly, where it gives rise to high effective marginal tax rates, poverty traps and other unintended consequences).

Importantly though, as argued above, not every policy change in the direction of either means testing or universality implies a move towards a particular approach to welfare at the macro level. Indeed, for example, it is possible that some forms of universalism can potentially have the effect of eroding others (some have argued that the non-means tested private health insurance rebate had precisely this effect in relation to Medicare). Further, it is possible that universalism in particular categories of welfare, if they are introduced concurrently with more rigorous conditionality for other categories of welfare, can undermine key objectives of universal/encompassing systems (for example, social cohesion).

The role of values and associated objectives is also vital in understanding the middle class welfare debate. An Australian commentator on public policy issues has argued that:

Public policy should proceed from articulation of underlying values, through statements of principles, to details of programs giving effect to those principles. For the most part, however, the political processes have generally been confined to the last step, with people left to work out the principles by inference.<sup>168</sup>

What seems clear is that the debate about the middle class and welfare could be made more productive if participants were clearer about the values and objectives underpinning their perspectives. Those considering the rights and wrongs of middle class access to welfare may also wish to consider the following issues:

- what should be the role of welfare? Should it mainly be about redistribution of wealth to those in need or are other objectives equally as important? Is it appropriate to trade-off principles such as equity in pursuit of other objectives?

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168. I McAuley, 'Integrated health care begins with values', *Health issues*, no. 82, 1 March 2005, p. 12.

- should we treat all areas of welfare in the same way? For example, should we treat income support benefits in the same way as health care services?
- what should a twenty first century (post-global economic crisis) conservative, liberal, social democratic or green position on welfare look like?
- is the design of Australia's current welfare arrangements (non-contributory, predominantly means tested income support combined with (largely) non-contributory, non-means tested health care benefits) appropriate to meet current and future challenges such as rising unemployment (potentially sustained at very high levels) and the ageing of the population?
- what should be the role of the state? Political and economic debates for several decades have been premised on the virtues of small government and the 'withering away of the state' as part of globalisation. Does the interventionist response by international governments to the global financial crisis mean looking differently at these issues? Is the state regarded as having a legitimate role in social investment through the welfare system? Are people willing to pay higher taxes in order to pay for an expanded state role in welfare?<sup>169</sup>
- the response to the global financial crisis has highlighted the role of (non-means tested) 'corporate welfare' in promoting economic and social stability. Does this have any implications for our understanding of means tested welfare?

These are difficult questions (and far from the only ones that might be asked in relation to this topic) but the answers to fundamental questions such as these should form the basis of attempts to respond to the complex issues associated with middle class welfare in Australia.

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169. Opinion polling has shown that Australians tend to want *both* less tax and more social services. This is known as the 'more for less paradox'. R Grant, *Less tax or more social spending: twenty years of opinion polling*, Research Note No.57, 2003–04, Parliamentary Library, Canberra, 2004, p. 9.

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