Logic, evidence and politics: the structure and adequacy of social security payments
Outline

• The logic of the structure
  – Philosophical considerations
  – ‘Guaranteed minimum income’ schemes (Friedman, Henderson, ISR)
  – Essential logic of late 1970s: categories, payment structures, means tests
  – Changing views and changing logic to late 1990s
  – Further changes in views and logic since 2000
• Evidence considerations
  – ‘Poverty lines’ (Henderson, OECD)
  – Relativities (Harmer Report, Henry Report)
  – Incentives (Harmer, Henry, PC)
  – Demography (Harmer, Commission of Audit, CEPAR etc)

• Political factors
  – ‘Deserving’ and ‘undeserving’ poor
  – ‘Welfare dependency’
  – Winners and losers
  – Different perceptions of tax and transfer measures

• Directions for future reform
The logic of the structure

• Philosophical considerations
  – Personal responsibilities
  – Family obligations
  – Rawlesian concerns (‘there but for the grace of God …’)
  – Social insurance vs social assistance
  – Safety nets and social investments
  – Vertical and horizontal equity
• Guaranteed minimum income schemes
  – Friedman (1950s): modest universal demogrands (or equivalent)
  – Henderson 1975: incremental reform proposals
    • Two sets of categories (‘Australian pension’ and ‘Australian benefit’)
    • Standard payment structure for both categories but different means tests
    • Family payments for those outside categories, skewed to large families
  – Henderson 1975: preferred GMI scheme
    • High level demogrand for income units in defined categories, payments above poverty line
    • Low level demogrand (around 60% of high level) for other income units
    • 40% income tax on all private income (no separate means test)
  • Standardise payment structures for those in defined categories, and clarify eligibility (e.g. sole parents)
  • Distinguish between long-term pensions and short-term benefits via different means tests (and standardise these tests and tax treatment)
  • Low level dependant allowances only (universal family allowances and dependent spouse rebate) for those outside categories
Henderson Poverty Inquiry recommended GMI scheme
• Essential logic of structure in late 1970s
  a. Categorisation based on risk: eligibility for those unable or not expected to work
  b. Payment structure for those in categories based on size and composition of the income unit (family), sufficient to live on
  c. Payments for those outside categories for dependants only, not linked to the rates for families in categories
    • If strictly based on horizontal equity and ‘capacity to pay tax’, logic might have suggested payments of around 30% of those for dependants in category families
    • Payments for children in cash; tax rebate for dependent spouse
d. Means tests for payments to those in categories, based on vertical equity considerations
   i. With taper for ‘pensions’ to retain incentive to supplement pension with income from work or savings (reversing earlier move to universal age pension)
   ii. $ for $ for ‘benefits’ given eligibility conditions (work tests) promoting return to work

e. No means test on payments for those outside categories, based on horizontal equity considerations
• Changing views and changing logic, to end 1990s (including Cass Social Security Review)
  – Shift in emphasis towards vertical equity over horizontal equity
  – Different views about dependency, the role of women and family vs individual responsibilities
  – Demand for form of social insurance to improve retirement incomes beyond level of the pension
  – Impact on structure
    • Family Income Supplement addressed vertical equity to assist working poor and remove anomaly of beneficiaries with large families losing money on gaining employment
    • FIS subsequently broadened and, eventually, family allowances means-tested
• Categories tightened to exclude wife’s pension, widow class B pension, age pension for women aged 60-64; sole parents encouraged to work through JET
• Spouse rebate abolished for those without children and subsequently replaced by parenting allowance
• Distinctions between those within and outside categories blurred with revised family tax benefits and parenting allowances focused on child payments and payments in respect of the care of children whether in category families or not
• Childcare subsidies for working parents introduced and widened
• Distinctions amongst the categories also blurred with relaxed means test for beneficiaries to promote some work while receiving payments, and increasing numbers gaining eligibility for DSP (though more than offset by phasing out of wife pension etc)
• New mandated superannuation contributions and changed tax incentives will reduce reliance on age pension over time (multi-pillar approach – see next slide)
SOCIAL SECURITY/SOCIAL PROTECTION FOR AGED

Pillar 1
PUBLIC PENSION PLAN DB/NOTIONAL DC MANDATED

Pillar 2
OCCUPATIONAL PENSION PLAN FULLY FUNDED DB/DC MANDATED

Pillar 3
OCCUPATIONAL PENSION PLAN OR PERSONAL PENSION PLAN VOLUNTARY

Pillar 4
INFORMAL SUPPORT (FAMILY) INDIVIDUAL FINANCIAL ASSETS HOME OWNERSHIP VOLUNTARY

“ZERO” OR FOUNDATIONAL PILLAR BASIC OR SOCIAL PENSION UNIVERSAL OR MEANS-TESTED
• Further changes in views and logic (since about 2000)
  – Increasing emphasis on workforce participation to address demographic change
  – ‘Conditionality’ strengthened through both sticks and carrots
  – Impact on structure
    • Work for the dole, income management, some sole parents to Newstart
    • CPI-only indexation of Newstart
    • Further expansion of childcare subsidies, introduction of PPL
    • Age pension age increase to 67
    • Henry Report view re categories (pension, participation and student categories) and family payments (FTB Parts A and B and childcare)
    • NDIS
Henry Report income support payment structure

- Basic rate
  - No child (e)
  - Parent young child
  - Parent school aged child
- Participation category
- Student category
- No child full work capacity
- No child partial work capacity
- Parent (b)
- Parent (c)
Henry Report family payments
Evidence considerations

• Poverty lines
  – Henderson: based originally on US data on cost-of-living relativities linked to minimum wage plus child endowment; later applied to a ratio of average male earnings for a single person (now using HDI per capita)
  – OECD: an arbitrary benchmark of half (or 60%) median household income and somewhat arbitrary approaches to equivalence (eg 0.7 for each additional adult and 0.5 per child; using the square root of household size)

• Income support trend data
Income support payments

- Single Pensioner
- Pensioner Couple
- Single Allowee
- PPS 2 chld <5 +RA
- YA 18-20 years

$ per week - (Nov 2013 Dollars)
• Relativities
  – Harmer Report:
    • Arbitrary recommendation for same rate for age pension, DSP and carers pension (specific costs for health and disability via targeted services)
    • Evidence on movement in rates (purchasing power and relative to community incomes), ‘low-cost budget standard’ from SPRC, comparison with ‘poverty lines’, wellbeing surveys and ministerial correspondence
    • Conclusion that single rate for those living alone was too low, single rate should be between 64-67% of combined married rate and rent assistance should be increased
– Henry Report

• Evidence on movements in rates, comparison with poverty lines, duration on benefits, transfers between payments, net earnings replacement rates

• Recommendation that differences in rates between categories should be reduced and the relativities then maintained

• Evidence on costs of different aged children, complexity of current family payment arrangements, cost of childcare, workforce participation

• Recommendations:
  – maximum rates based on age, ensuring access to acceptable standard of living;
  – for those with a child under 6, an additional payment to support balance between work and family responsibilities;
  – single parents and those on income support with children not under 6 to receive additional family payment;
  – single childcare subsidy based on percentage of costs, higher rate at low incomes
• Incentives
  – Harmer Report
    • Evidence on workforce participation amongst different pensioner groups, evaluation of impact of pensioner bonus scheme
    • Recommendations include replacing bonus scheme with concession for employment income, targeted support for disability pensioners and carers, tighter pension taper
  – Henry Report
    • Evidence on emtrs, workforce participation rates and family characteristics, labour supply research, international comparisons, impact on different types of means
Recommendations include reduced taper for sole parents and smoothed taper for family payments, continued universal access to child care assistance, comprehensive income test (no separate assets test) for income support payments.

– Productivity Commission report on childcare
  • Evidence from surveys of parents of young children, workforce participation, and modelling impact of increased childcare support on workforce participation (but not impact of other family payments)
  • Recommendation for expanded and simplified childcare support
• Demography
  – Harmer Report
    • Evidence on dependency ratios, life expectancy
    • Recommendation to gradually increase age pension age by two to four years and also increase superannuation preservation age
  – Commission of Audit
    • Evidence on dependency ratios, IGR projections
    • Recommendation to preserve ratio of life expectancy above pension age to overall life expectancy, with further phased increase in pension age to 70 years
– Other research

• CEPAR on wide variations in health and employment capacity within the average improvement in years of healthy living

• Gregory on limited financial gains from increasing age pension age given changing profile of full and part pensioners

• Whiteford on changing profile of income support recipients below age pension age

• Others (including McDonald) on shift in demographic profile away from families towards older couples and single-person households; also big shift from full-rate to part-rate pensioners
Political factors

• ‘Deserving’ and ‘undeserving’ poor
  – History of long periods of eligibility restrictions and lower payments for particular income support categories (e.g., single unemployed, unemployed and sick, sole parents (other than widows))
  – Some genuine dilemmas: high risk of ‘moral hazard’, reliance on subjective eligibility criteria, but danger of penalising genuine cases

• Welfare dependency
  – Broader concerns about costs of system, disincentives to self-reliance
  – Genuine dilemma: balancing targeting, adequacy and incentives to work and save
• Winners and losers
  – Every initiative involves winners and losers at the margin
  – Genuine dilemma: there is never a clean slate for reform that can be promoted simply on the basis of principle and logic.
    • Path dependency is real

• Different perceptions of tax and social security
  – Cash payment emphasis on vertical equity and family-based means testing; tax measures emphasis on horizontal equity - universality (or increasing with income) – and individual income assessments
  – Artificial (?) dilemma: losing horizontal equity when tax benefits transferred to social security, and increasing emtrs for second earners
Directions for future policy reform

- Should the structure return to the logic of categories, rates of payment and means tests?
- What categories are now appropriate?
  - Is Henry’s distinction between ‘pensions’, ‘participation’ and ‘students’ useful?
  - Or is Henderson’s distinction between long-term pensions and short-term benefits preferable?
  - Should sole parents be explicitly amongst the categories?
  - Should eligibility for categories be further tightened?
  - Should students be a category at all?
What rates of payment should apply to those in the income support categories?

– Should we return to a single set of payments?
– If not, on what basis should different sets of payments be established?
– Could the Harmer Report methodology be applied to other categories?

What means tests should apply to the categories?

– What taper is appropriate for short-term benefits to retain incentives for full-time work?
– What taper is appropriate for longer-term pensions, and how should (different) assets be treated, given superannuation?
• What assistance is appropriate for those not in categories?
  – For the direct costs of dependent children and the (direct and opportunity) costs involved in their care?
• What rates of assistance should they receive?
  – Should the maximum be the same as or lower than for those in categories?
  – Should childcare costs be treated differently to the costs of those families choosing not to use formal (paid) care?
  – When should payments be made direct to a dependent student?
• What means tests should apply to payments to non-category families?
  – Is horizontal equity really in conflict with vertical equity?
  – What profile of emtrs would achieve ‘best’ incentives for workforce participation?
  – What test should apply to student dependants themselves?