

9. The transfer system

A 21st century tax and transfer system should reflect the commitment to Australian values of fairness and support for those who are disadvantaged, but do so in a way that is efficient, sustainable, simple and transparent, and internally consistent.

With changing social expectations and increasing age dependency, there is likely to be a greater expectation in the future that transfer recipients who are able to support themselves through work will do so. More generally, if Australia is to pursue a high-growth response to the fiscal challenge of an ageing population it is critical that transfer payments are designed to provide a strong incentive to work. This could be achieved by building clear work incentives into the levels of income support payments, by tailoring means test arrangements according to the participation opportunities and expectations of recipient groups, and through improved support for quality child care.

The broad architecture of Australia's transfer system is well suited to these goals. Australia has the most progressive transfer payment system in the OECD, reflecting effective targeting of support to low income households. However, the system is overly complex, can treat people of similar means differently and can result in people making choices that potentially undermine lifetime wellbeing. It would benefit from a more principles-based approach to setting payment levels and the design of payments to improve workforce participation incentives. Streamlining payment types and applying a comprehensive means test base would ensure a more consistent treatment of payment recipients. Establishing adequacy benchmarks for transfer payments not considered in the Pension Review would make the system more robust, particularly if the benchmarks were preserved through a common but sustainable indexation arrangement.

While full integration of the tax and transfer systems is considered impracticable, given their different objectives, better coordination between them is desirable. A coordinated approach should extend to the consideration of housing assistance, access to aged care and transfers that are tied to expenditure on other goods and services. A coordinated approach would support greater equity between transfer recipients, reduce the inherent disincentives to work created by taxes and transfers and underpin a better client experience of the tax and transfer system.

9.1 Three types of income support payment

Income support is a crucial social institution. Its primary focus should continue to be the provision of a minimum adequate level of income to people who are unable to support themselves through work or their savings. It should be based on three broad payment types (see Chart 9.1).

- Pensions should be available to people who are not expected to work and be sufficient to provide an adequate standard of living, based on an accepted community standard.

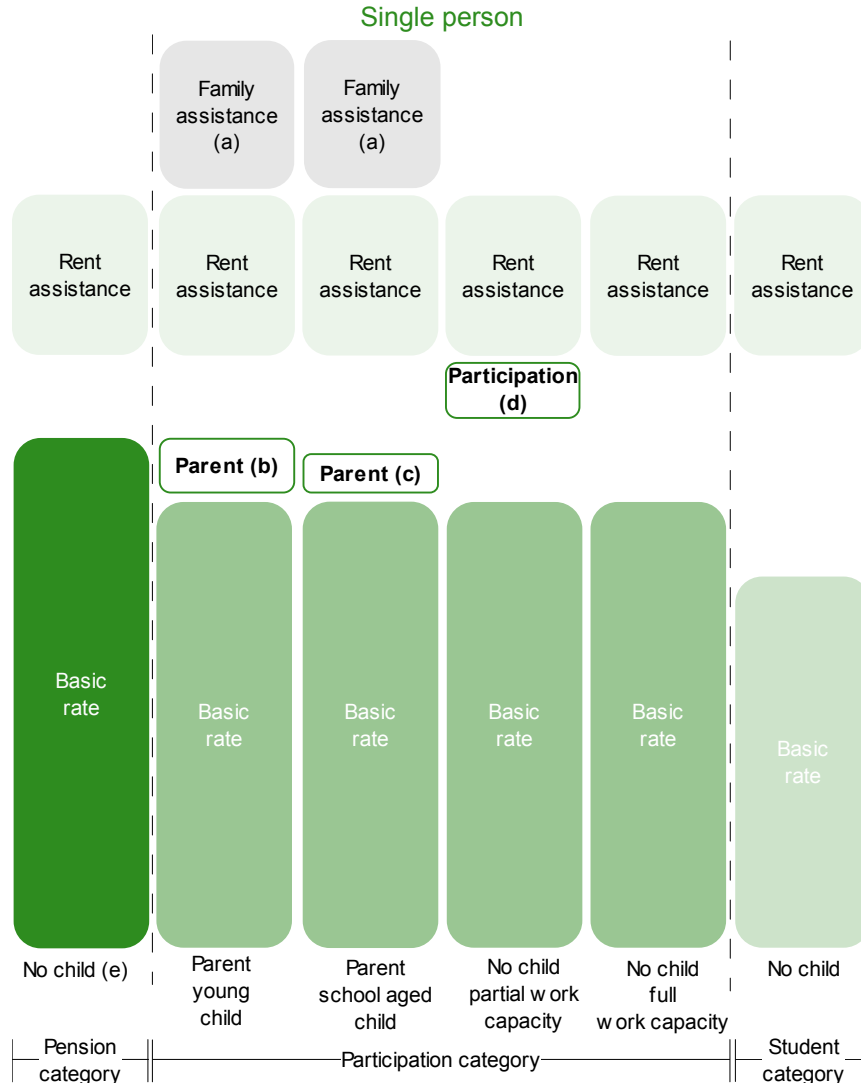
- Participation payments should be available for people who are able and expected to work, now or in the near future. Rates of payment should provide a basic level of adequacy and means test settings should provide incentive to seek employment.
- Student assistance should be paid at a rate less than the participation allowance rate. Some students have the capacity to work part-time. However, students should not be expected to work to an extent that undermines the benefits of their study. Students should, therefore, be able to access a loan facility to provide additional income up to the participation rate.

In addition to these three types of income support payments, supplements could raise the level of income support for parents (Parent Supplement) and assist with the direct costs of renting (Rent Assistance) and children (Family Assistance).

Parents would be eligible, subject to means, for additional assistance that would raise the level of their income support above the rate for those without children. The level of the parent supplement would vary with the age of the youngest child. For couples and single parents with a youngest child under six years, the supplement would be paid through the family payment system. Its level should be set such that the total support for single parents wholly reliant on income support would be equivalent to the maximum rate of pension. For couples whose youngest child is aged six years or older, the family supplement should be paid at a lower rate through the income support system. For single parents with a youngest child aged six years or older, this lesser amount should be paid through the family payment system, subjecting it to a gentler withdrawal rate. As a condition of receiving these payments, primary carer parents would have a requirement to look for part-time work once their youngest child reaches four years of age.

People with disability and with a partial capacity to work who receive a participation payment would be eligible for a participation supplement, which would provide an incentive to work part-time.

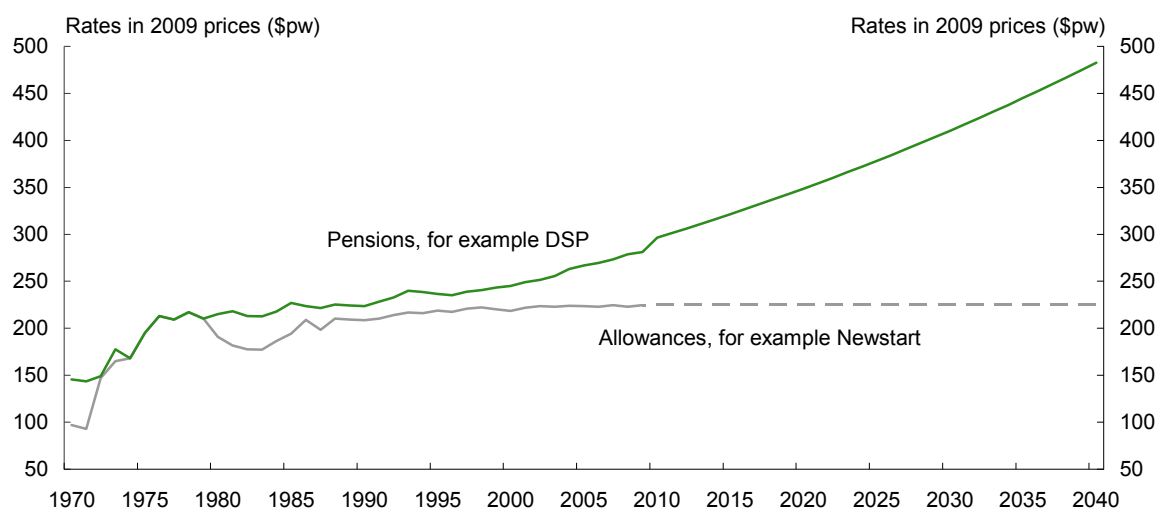
Chart 9.1: Indicative structure of adult working-age income support



- (a) Family assistance for the direct costs of children.
- (b) Parent supplement for families with a youngest child aged under six would be paid through family assistance and be available to working families.
- (c) Parent supplement for single parents with a youngest child six and older would be paid through family assistance. For partnered parents it would be paid as part of income support.
- (d) Participation supplement could be delivered through the means test.
- (e) Age, Disability and Carer pensioners would be eligible for the parent supplements.

There are currently large differences in rates and conditions of payment, especially for people of working age, which produce very different outcomes for people with a similar ability to work. These differences can create disincentives to work or incentives to move to higher payments. The differences in rates of payment are increasing as a result of differences in their indexation (see Chart 9.2).

Chart 9.2: Pension and allowances over time^(a)
2009 prices



(a) Projected values assume no policy change.
Source: Treasury estimates.

To improve fairness, the current differences in rates of payment should be reduced by gradually increasing the single person rates of payment in the participation and student categories. The rates of payment for single people in these categories would be lower than the amount paid for single pensioners. However, there should be a consistent treatment of the amount paid to single people compared to the amount paid to couples in the income support system. Once established, the relativities in the levels of adequacy in the three payment categories should be maintained through a consistent approach to indexation. Indexing to the current community standard for pensions would involve a significant cost, so governments will need to regularly review the benchmark.

9.2 A more comprehensive definition of means

Means testing is an important tool for targeting government payments to those with most need and for managing the sustainability of the transfer system. It is a defining characteristic of Australia's highly targeted transfer system, which should be maintained. However, it could be improved so that income and assets are more fairly assessed and incentives to work and save are strengthened.

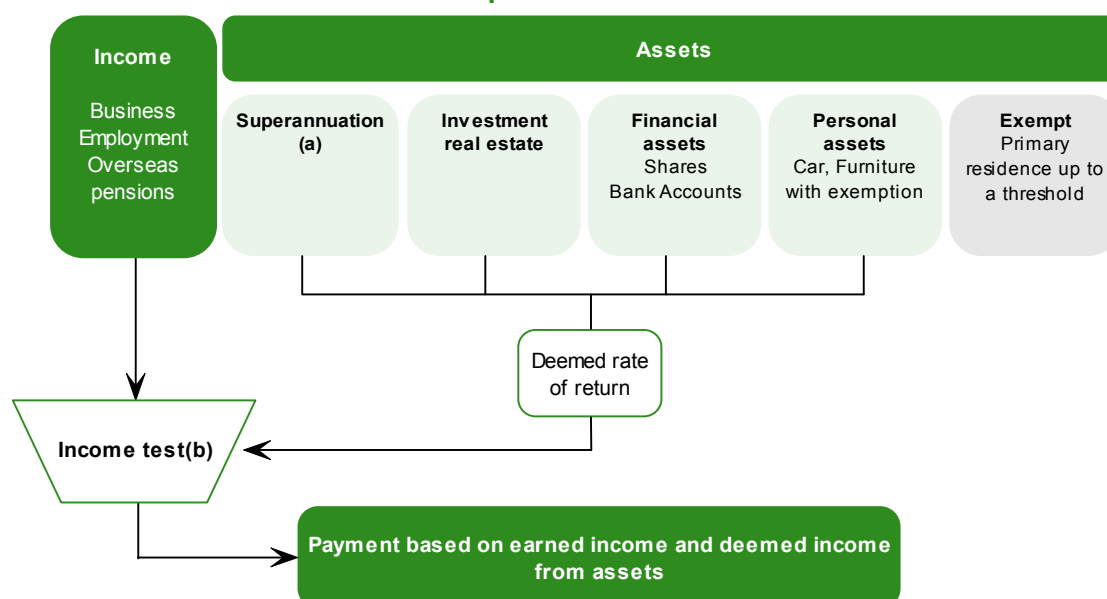
The concept of means for income support payments should include not only income but also the ability of a person to generate income from their assets. Striking an appropriate balance between targeting need and maintaining incentives to work and save is a significant challenge in designing a means test. Further, means testing can increase the complexity a person faces in interacting with the tax and transfer system.

A comprehensive means test base that determined access to all income support payments, including Newstart Allowance and the Age Pension, should replace the current two part means test — the income test and the assets test. This would involve deeming an income on most assets (see Chart 9.3). The deeming rates would be based on the returns expected from a portfolio of assets held by a prudent investor.

The comprehensive means test base would be fairer and less complex. Under the current two-part means test, people can receive different levels of government payments even though they have the same level of wealth. This is because some assets are assessed under both tests, while other assets are assessed only under the assets test.

The comprehensive means test base would provide a platform for tailoring the means test parameters, such as free areas, withdrawal rates and earnings disregards, to the circumstances of particular groups. These would determine the amount of income support payment.

Chart 9.3: A comprehensive means test base



(a) Deeming on account-based superannuation assets would apply from Age Pension age. Special arrangements would apply to income streams where deeming is difficult. Superannuation assets would not be deemed for people under Age Pension age unless they are being drawn down.

(b) Free areas and withdrawal rates would apply to determine the amount of income support payment.

The new means test would not apply to family payments. These would continue to be assessed on taxable income.

9.3 Better targeted family-related payments

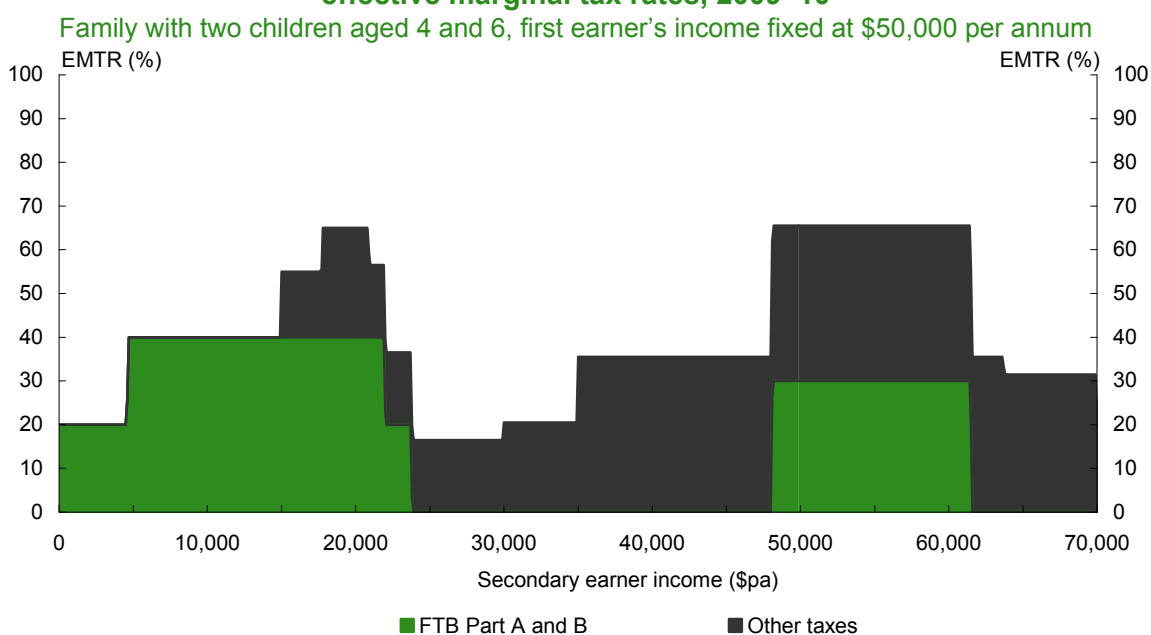
Family payments are integral to the total package of support available to families, particularly families with insufficient private income to support themselves and their children. They also provide a degree of horizontal equity between taxpayers with dependent children and taxpayers not supporting children. This horizontal equity role must be traded off against the higher cost of providing more universal family assistance.

Family payments should cover the direct cost of children in low-income families. Multiple existing payments should be replaced with one simple age-based family payment designed to reflect the additional cost of children as they age. It should be means tested in accordance with family taxable income (on the same base as for tax) in a way that minimises workforce disincentives.

Current rates of assistance do not always reflect the direct costs of children, particularly older children. For example Family Tax Benefit Part A rates are broadly adequate for 5–15 year olds, more than adequate for 0–4 year olds, but below the cost of children for 16–17 year olds (as is Youth Allowance).

Multiple family payments result in stacking of withdrawal rates, reducing the return to paid employment and unnecessarily discouraging participation. The simultaneous withdrawal of Family Tax Benefit Part A and Family Tax Benefit Part B adds to effective marginal tax rates of second earners (see Chart 9.4).

Chart 9.4: Effect of withdrawal of family payments on secondary earner's effective marginal tax rates, 2009–10



Notes: Family Tax Benefit Part A begins to withdraw at a rate of 20 per cent when family income is \$44,165, while Family Tax Benefit Part B begins to withdraw at a rate of 20 per cent when the second earner's income is \$4,672. The combination of these withdrawal rates, together with income tax rates, can lead to high effective marginal tax rates (EMTRs). Other taxes include the marginal tax rate, the low income tax offset and its withdrawal, and the Medicare levy shade-in.
Source: Treasury estimates.

Family payments have a role in ensuring that the choice to spend a reasonable length of time out of the workforce to care for young children is not constrained by financial need. Paid parental leave provides a strong signal that an absence from employment is appropriate and provides an alternative source of income for primary carers after the birth of a child.

Beyond the immediate post-birth period covered by paid parental leave, many parents continue to stay out of the workforce or reduce their hours of participation to provide care for young children. While the youngest child is under six years of age, low- to middle-income families should be supported to balance work and family responsibilities with an additional supplement through the family payment system tested on family income.

For parents with a youngest child aged six years or older, a supplementary per family support should be provided for couples receiving income support and single parents on low and middle incomes through the family payment system.

Family payments should be the main form of assistance for children aged up to 18 years, or until the completion of secondary school in the year a person turns 18 years. Beyond these

points, youth payments focused on encouraging study, training or workforce engagement should be available.

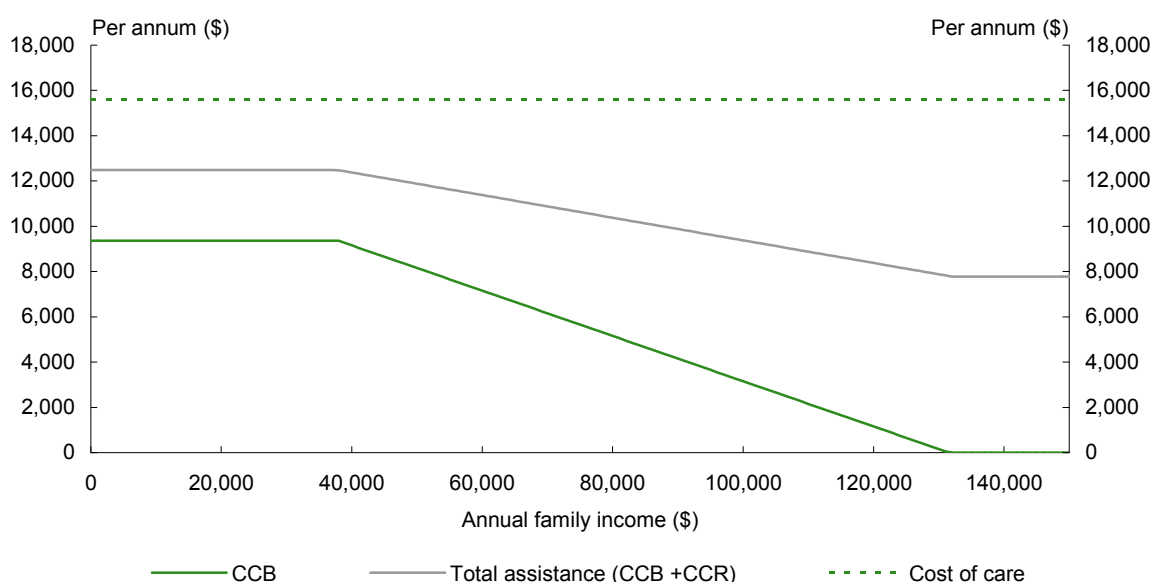
There should be a seamless transition from family assistance to income support for young people. This should be based on the person's circumstances and only one payment should be available in each circumstance, rather than families having to choose between youth and family payments. Assistance would still need to be flexible, to accommodate diverse transition paths by recognising earlier independence in a number of circumstances.

9.4 Child care

Access to high-quality and affordable child care can be an important factor in a parent's decision to remain in or return to the workforce. Child care assistance provides secondary earners and sole parents with material support to participate in the workforce. Assistance with child care costs recognises that child care is a cost of employment and thereby reduces the disincentives to participate that are created by the tax and transfer system. Access to quality child care also plays a role in early childhood development, particularly of children from families experiencing, or at risk of, social exclusion.

Currently, there are two main child care payments: Child Care Benefit (CCB) (a means-tested per hour rate of assistance payment) and Child Care Rebate (CCR) (which covers 50 per cent of out-of-pocket costs). These two payments combine to provide a total level of assistance which is higher for low income families and still significant for middle and higher income families (see Chart 9.5).

Chart 9.5: Child care assistance, 2009–10
One child in full-time care (50 hours per week) assuming a weekly fee of \$300 per week



Note: Assumes that the child is in approved care and not of school age and that the child care fee is constant across all income levels.

Source: Treasury estimates.

Child Care Benefit and Child Care Rebate should be combined into a single payment to make child care assistance simpler and more transparent. The new payment should be set as

a percentage of out-of-pocket expenses to ensure that the rate of assistance is maintained over time and that it accommodates the wide distribution of child care prices in Australia.

Low-income families should receive a high rate of assistance to facilitate workforce participation and support the use of child care for early learning and development. The payment should be means tested, but all families where parents participate in work, training or study should have access to a base rate of assistance, set with reference to the marginal tax rate faced by most taxpayers.

9.5 Housing assistance

Access to adequate housing is integral to a decent life enabling full participation in society.

Including Rent Assistance as part of the income support system allows assistance to be targeted to need and delivered in a way that does not discourage workforce participation. However, the current maximum levels of assistance are too low for many people to secure an adequate standard of housing. Further, indexation of assistance to the Consumer Price Index means that assistance is not well targeted over time, leaving recipients to bear the risk of rent fluctuations.

Rent Assistance should be increased so that assistance is sufficient to support access to an adequate level of housing, and indexed to market rents. Rent Assistance should also be extended to public housing tenants, with tenants charged rents that reflect market rates, subject to grandfathering or other transitional arrangements.

Public tenants currently receive a higher average level of assistance than private tenants, with assistance poorly targeted to need. As most public tenants have similar means to recipients of Rent Assistance, the large difference in assistance levels is inequitable. The gap in assistance leads to rationing of access to public housing through queuing and can lead to poor outcomes for tenants in the long-term.

The use of queues to ration public housing and income-based rent setting discourages workforce participation. Further, public housing funding neither effectively targets assistance, nor encourages the use of the housing stock in ways that reflect the needs of clients.

Social housing providers should receive a new source of funding for tenants with high housing needs, such as those with high costs due to disability or people likely to face discrimination in the private market. The payment would be based on the needs of recipients and directed by them to providers of their choice. In combination with Rent Assistance, this assistance would encourage the formation of a more dynamic social housing market that would reduce reliance on the current system of block grants.

The Australian government and the States should retain the option of providing capital for social housing provision.

9.6 Transfers tied to goods and services

Governments also provide other transfers in the form of concessions or payments that are linked to the purchase, or supply, of a particular good or service.

The current approach to concessions should be reviewed, both in terms of how they are funded and provided, and how they interact with other parts of the tax and transfer system. The provision of this type of transfer across the three levels of government is not always consistent with other aspects of the tax and transfer system. The use of concession cards as a gateway to a number of concessions provided by the Australian, State and local governments creates a strong incentive for people to gain eligibility for concession cards. Further, some concessions are regressive, as they effectively provide higher value to people with higher means.

The Productivity Commission should review concessions across all levels of government and provide recommendations for consideration by the Council of Australian Governments (COAG).

The capacity of the tax and transfer system to deliver improvements to people's wellbeing is also highly dependent on how governments fund and provide other public services, such as health and education. Governments use a range of mechanisms to support access to these services and current arrangements can sometimes lead to unintended outcomes. Given that governments will face cost pressures in funding public services in the future, there is merit in reviewing the principles of public service delivery and the scope for services to be delivered in different ways.

Therefore, the manner in which public services are delivered should also be subject to further review, beginning with a Productivity Commission study to enable COAG to consider broad principles and directions.

9.7 Aged care

Access to adequate aged care services is a key determinant of the wellbeing of older Australians. The ageing of the population is expected to lead to strong demand for aged care from recipients with a wider range of needs and preferences. This will test the limited choice available within the current system and its fiscal sustainability.

Australia's aged care sector is complex in both its regulatory system and its funding arrangements. The priorities for governments are to determine what an adequate level of aged care should be, the necessary pricing and regulatory arrangements to deliver it, and the most sustainable funding arrangement to ensure access by those who cannot afford it.

There is considerable scope to reform aged care funding so that it is consistent with a recipient's needs and provided in a way that supports their choices. Unbundling government assistance for aged care into accommodation, care and daily living expenses would allow the most appropriate subsidy to be targeted to each (including consistent means-testing). It would also allow the biases to particular types of care to be removed and improve service quality, by directing resources to a recipient's preferred provider; for

example, allowing people to receive care in their preferred setting, whether in a home or care facility.

Implementation of these reforms to funding arrangements would be significantly limited by regulations that govern the supply and price of aged care. Reforming these regulations would involve complex sequencing and transition issues. The Productivity Commission should consider the potential to revise funding arrangements for aged care as part of its broader upcoming inquiry into aged care.

The long-term sustainability of aged care could be supported by insurance mechanisms, which could involve compulsory funding through levies applying to all personal taxpayers. The potential for this type of funding arrangement should also be considered by the Productivity Commission, as it would be similar to some of the social insurance attributes of broader disability insurance, into which the Commission is inquiring.