



# **Transfer issues and directions for reform: Australian transfer policy in comparative perspective**

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# Outline

- Why are we interested in the design of transfer systems?
- Nature and limitations of the approach
- The design of transfer systems
- Targeting, progressivity and redistribution
- How Australia compares
- Summary and some conclusions
  - Sources and additional material



## Why are we interested in the design of transfer systems?

- *“The tax-transfer system is the principal means of expressing societal choices about equity. The tax-transfer system is a reflection of the kind of society we aspire to be.”* Ken Henry, ACOSS National Conference, (2009).



# Caveats and limitations

- Approach is descriptive and based on statistical calculations.
- Most analysis is static.
- The counterfactual effectively assumes that the welfare state has had no incentive effects, or at least is the same in all countries.
- Some welfare state features treated as if they are produced by market mechanisms (e.g. minimum wages).
- Does not include non-cash benefits (health care, education, social housing, child care); indirect taxes – VAT, employer social security contributions also not included.
- Employer social security contributions are paid by businesses direct to government and do not pass through the household sector. Particularly problematic as they are one of main sources of funding for the welfare state.
- Employer provided fringe benefits not included.
- The distribution of wealth, including owner-occupied housing makes a difference.



## Australia's distinctive tax/benefit system

- Total Australian spending on social protection (cash benefits, health care, social services) is about 85% of the OECD average – but this is mainly due to much lower than average spending on age pensions; health, disability and social services are a little higher than average and cash benefits for people of working age about 10% higher and for families about 40% higher; cash transfers about 70% of average.
- Direct taxation paid by benefit recipients is among the lowest in the OECD, as is indirect taxation of benefits.
- Pension tax expenditures are the highest in the OECD (not counted in figures), but other tax expenditures below average.
- Mandatory private social benefits (sick pay and superannuation) amongst highest.
- Thus, net expenditure – after direct and indirect taxes paid on benefits – is even closer to average – and tax expenditures and mandatory private social expenditure increase Australia's ranking further.
- To assess distributional impacts it is necessary to look at all components of the system together – ideally.



## Types of redistribution in social security systems

- The design features of social protection differ in important respects - two of the most important features relate to the *funding* – i.e. the different ways in which programmes are financed – and *structure* of benefits – i.e. the relationship between benefits received and the past or current income of beneficiaries.
- Redistribution can be between rich and poor (Robin Hood) or across the lifecycle (the piggy bank) – risk insurance (against unemployment, disability, sickness etc.), savings (for retirement).
- All welfare states are a mix of the two, but the mix varies.
- Other types of redistribution – notably between men and women and also across regions.
- Behavioural effects may undercut redistribution; private provision also redistributes across the lifecycle.
- Point in time, static analysis implicitly treats all measured redistribution as if it were between rich and poor.
- Taking account of redistribution across the life course, the level of redistribution between rich and poor is less than it appears, but is still strongly associated with progressivity of benefit structure.

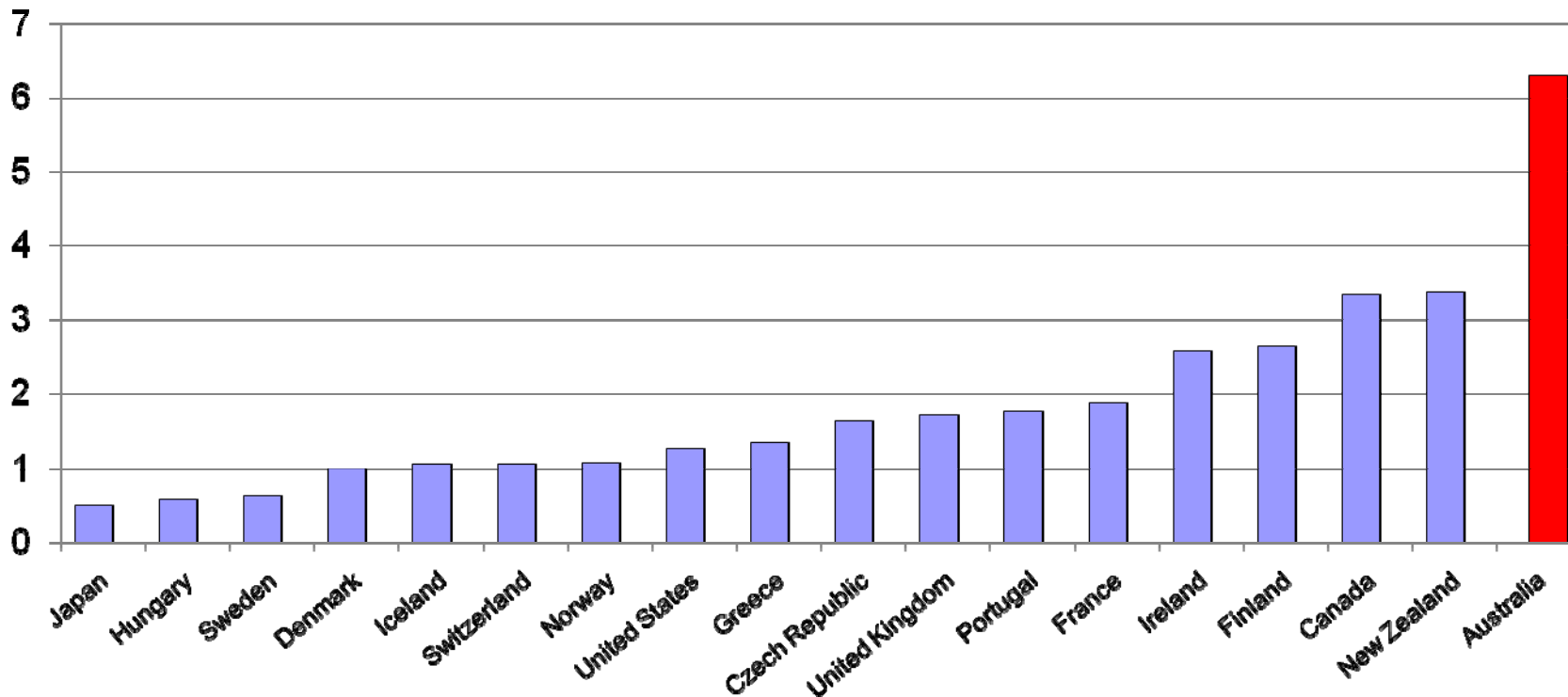


## Targeting, progressivity and redistribution

- *Targeting* is a means of determining either eligibility for benefits or the level of entitlements for those eligible. In a sense, all benefit systems – apart from a universal “basic income” or “guaranteed minimum income” scheme – are targeted to specific categories of people, such as the unemployed, people with disabilities or those over retirement age. Income and asset-testing is a further form of targeting that can be applied once people satisfy categorical eligibility criteria.
- *Progressivity* refers to the profile of benefits when compared to market or disposable incomes – how large a share of benefits is received by different income groups – e.g. do the poor receive more than the rich from the transfer system?
- *Redistribution* refers to the outcomes of different tax and benefit systems – how much does the benefit system actually *change* the distribution of household income?
- *Effectiveness* measured by how much redistribution is achieved; *efficiency* by the resources used to achieve this redistribution.

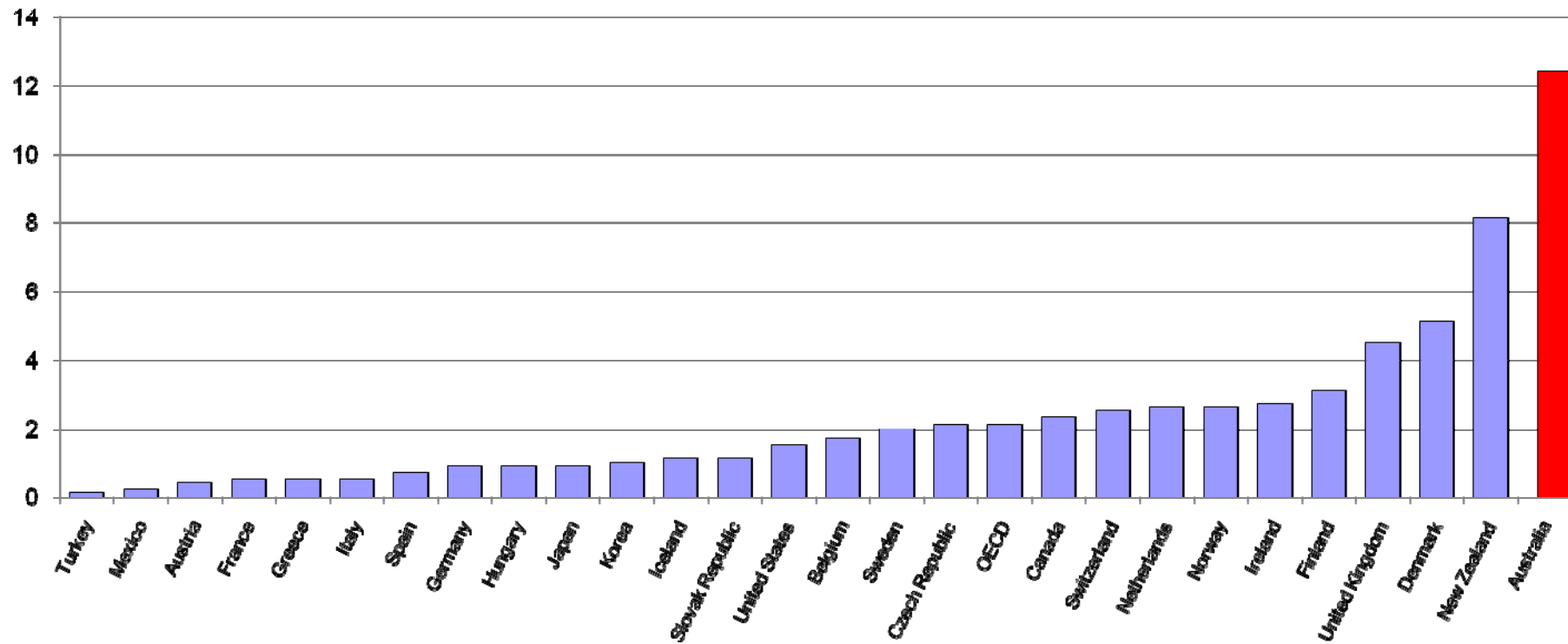
# Australia relies on income-testing more than any other OECD country

% of GDP spent on income-tested benefits, 2005



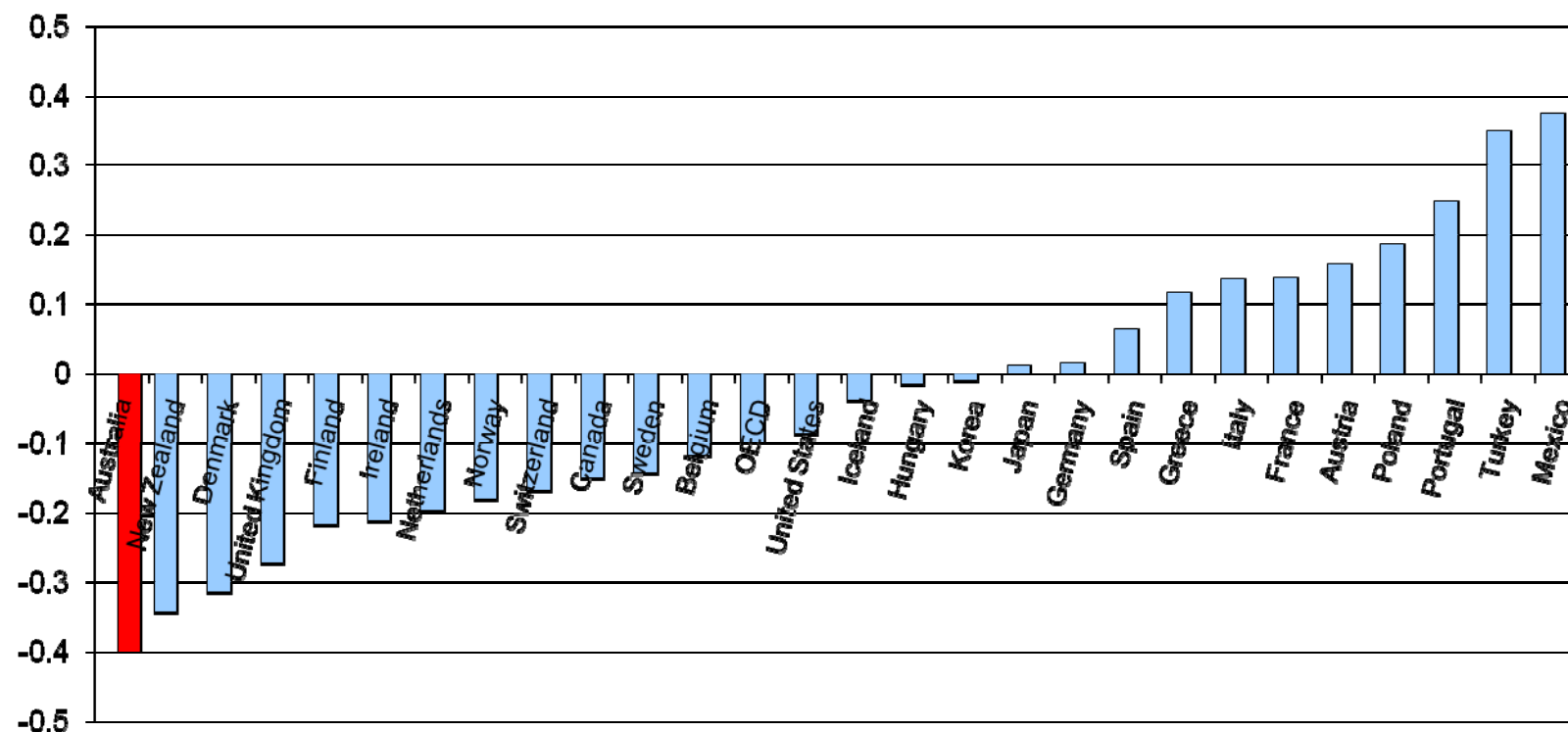
# Australia has the most progressive benefit system in the OECD

Ratio of benefits received by poorest quintile to benefits received by richest quintile, total population, 2005



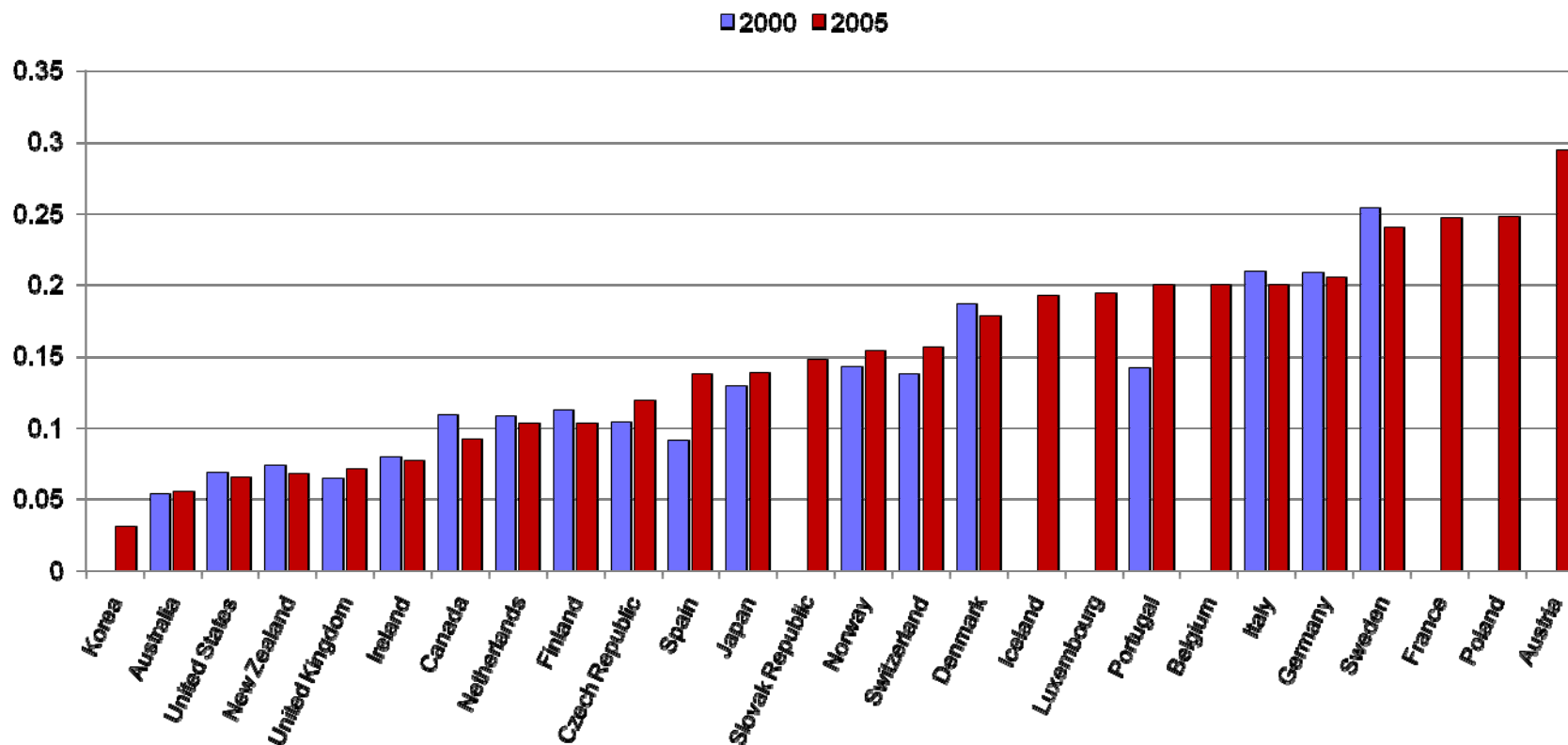
# Progressivity of transfers, 2005

Concentration coefficient of transfers



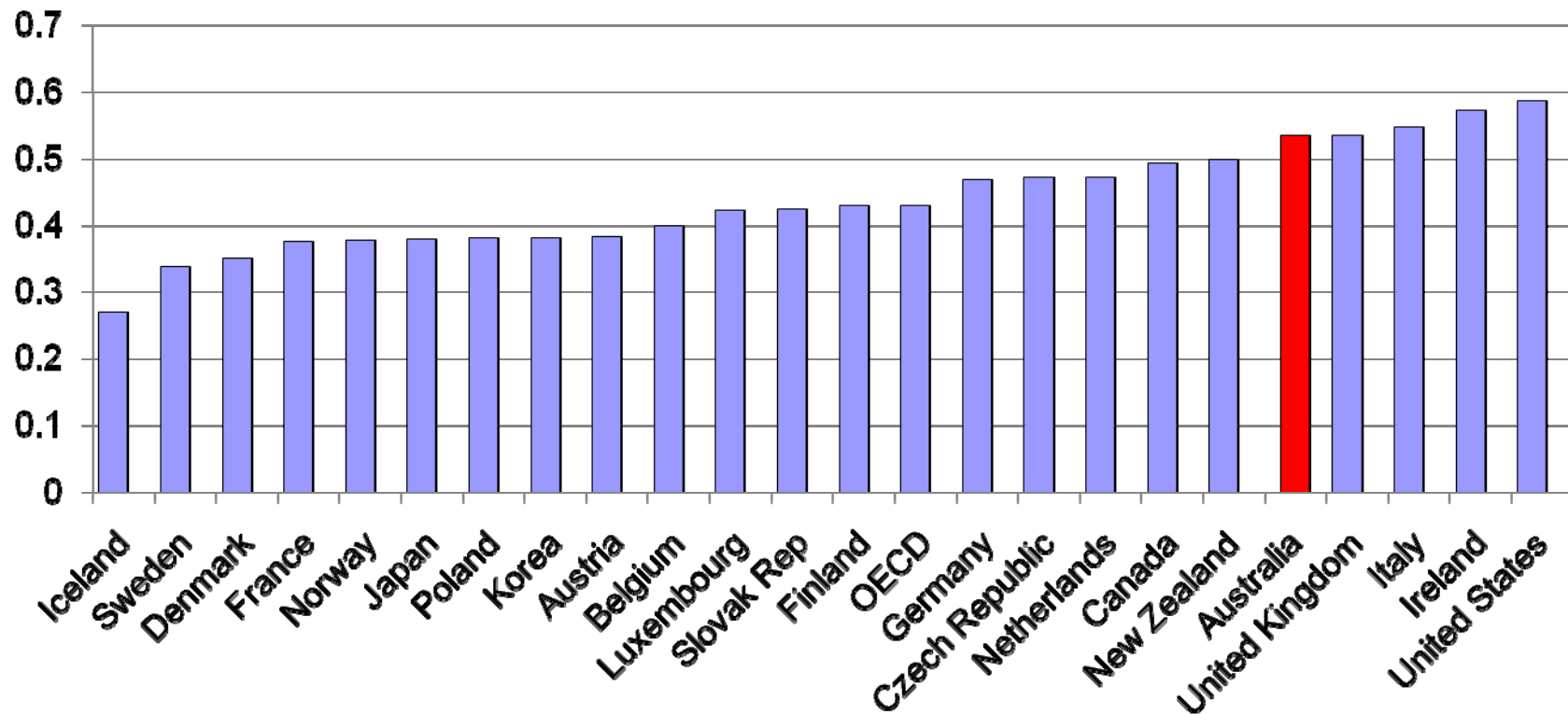
# Australia has low levels of churning

Churning as % of equivalent household disposable income



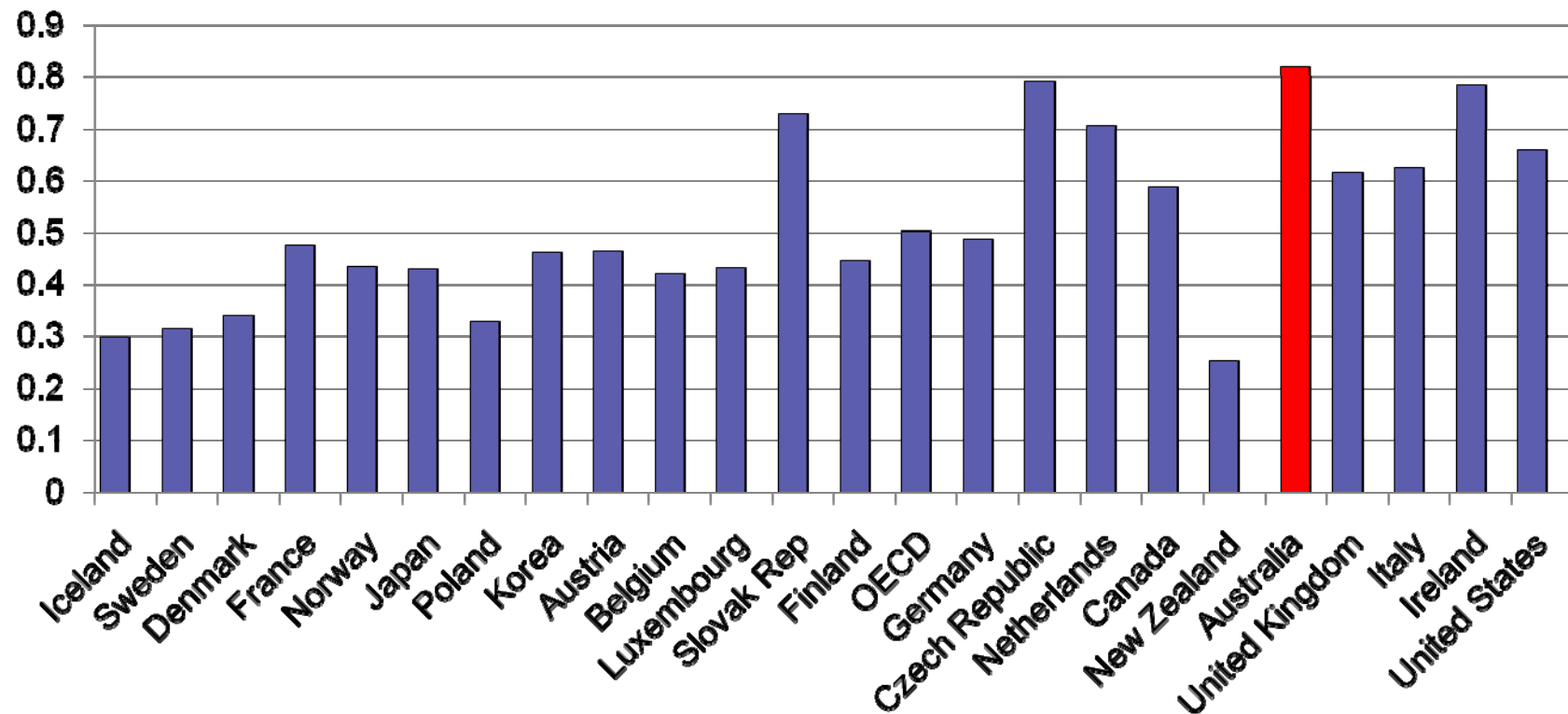
# The progressivity of direct taxes is highest in the English speaking countries and lowest in the Nordic countries

Concentration coefficient for direct taxes around 2005



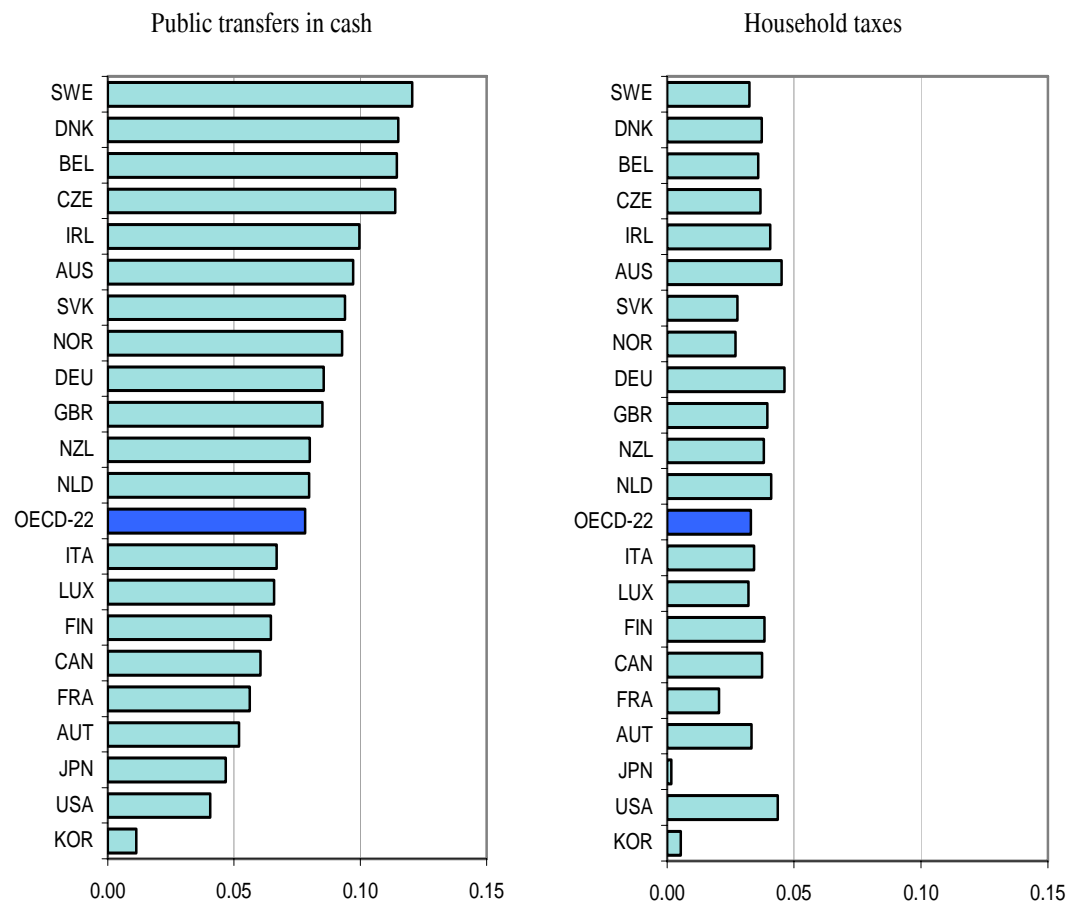
# Australia has the most progressive direct taxes on retirement age households

Concentration coefficient for direct taxes on retirement age households



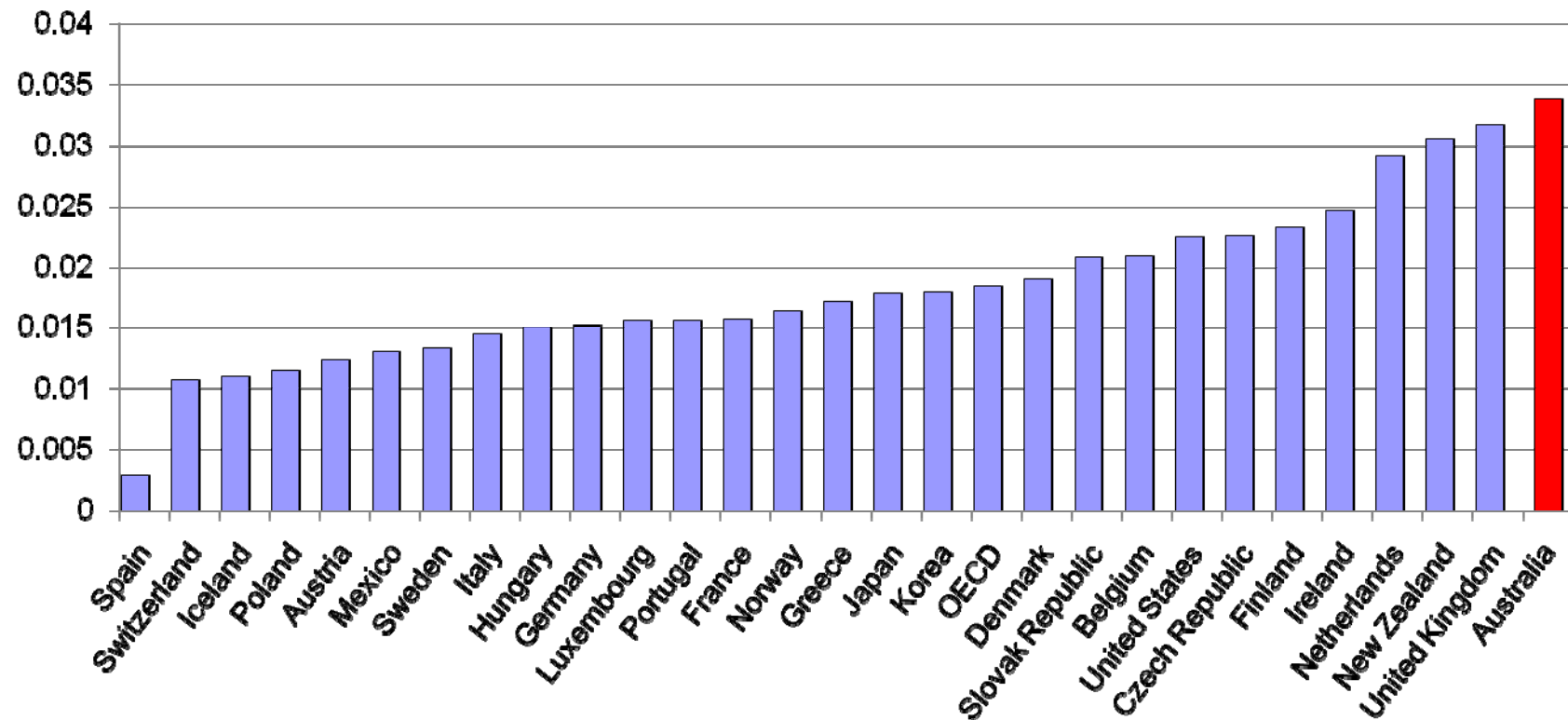
# Reduction in inequality due to public cash transfers and household taxes

Point reduction in the concentration coefficient



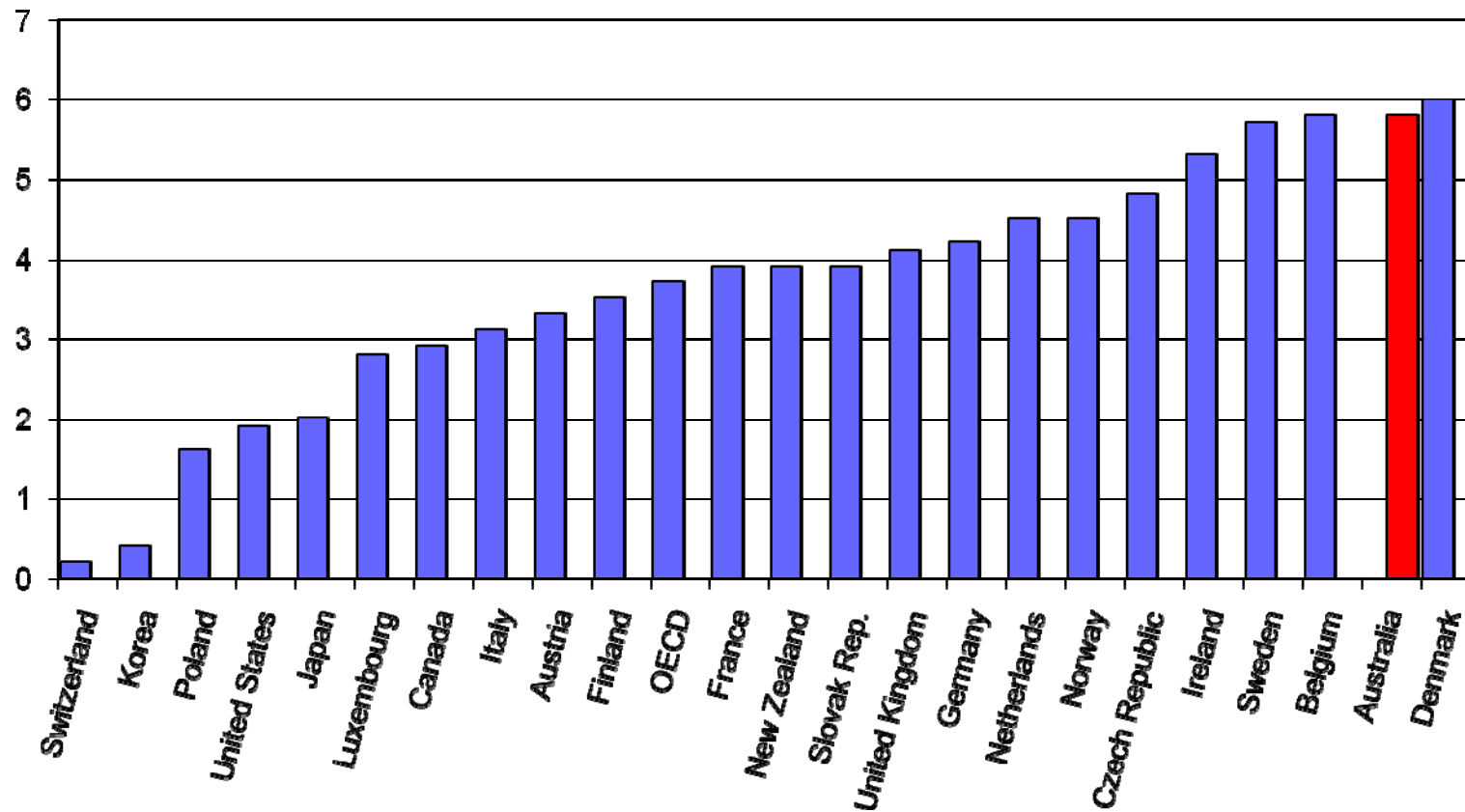
# Australia is the most efficient country in the OECD in reducing poverty

Point change in mean poverty gap per unit of transfer spending



# Net redistribution to the poor

Net transfers received by poorest quintile as % of household disposable income





# Summary

- Australia relies on income testing more than any other OECD countries, and has the most progressive structure of benefits of all OECD countries.
- As a result, as a percentage of household income, net benefits to the poorest 20% of the population are among the highest in the OECD.
- Australia also has one of the most progressive systems of direct taxes in the OECD, and has low and very progressive taxes on retirement age households.
- Australia has less “middle class welfare” than any other country, lower churning than nearly all other countries, and the highest level of transfer *efficiency* in reducing inequality.
- Australia (and Ireland) prove to be nearly as *effective* in reducing inequality as the Nordic countries, while the United Kingdom and New Zealand are about as effective as Germany in reducing inequality.
- Australia is the 8<sup>th</sup> most effective in OECD at reducing the poverty gap (about the same as Denmark), and the most efficient in reducing poverty gaps.
- But these are measures of programme efficiency, not economic efficiency.
- Efficiency is a means to an end – the goal is more effectiveness.

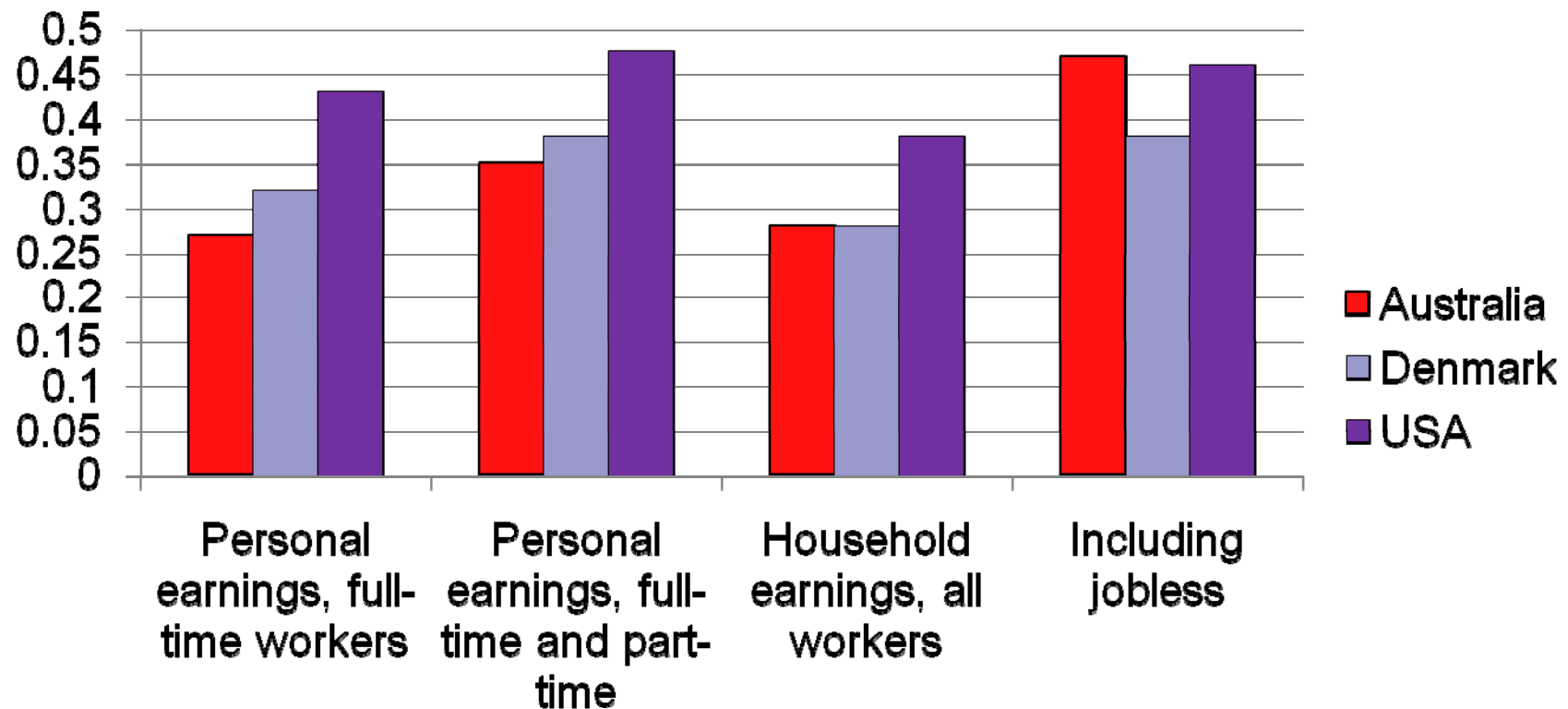


# Conclusions

- The broad architecture of the Australian system has considerable strength, so that in looking at reform options we should consider refurbishment and modernisation, not demolition and rebuilding.
- Despite impressive design features of tax and transfer systems, disposable income inequality in Australia is only just below the OECD average; if Australia is one of the most effective countries in the world at reducing inequality, then income inequality before taxes and transfers is higher than in most countries with better inequality outcomes.
- If Australia wants to be more effective it could either increase its high level of progressivity, or tax and spend more while at least maintaining effective progressivity, or identify the factors associated with its relatively high level of market income inequality and address these problems more directly.

# Inequality of earnings among households of working age, 2005

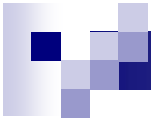
Gini coefficients for different earnings measures





# Conclusions

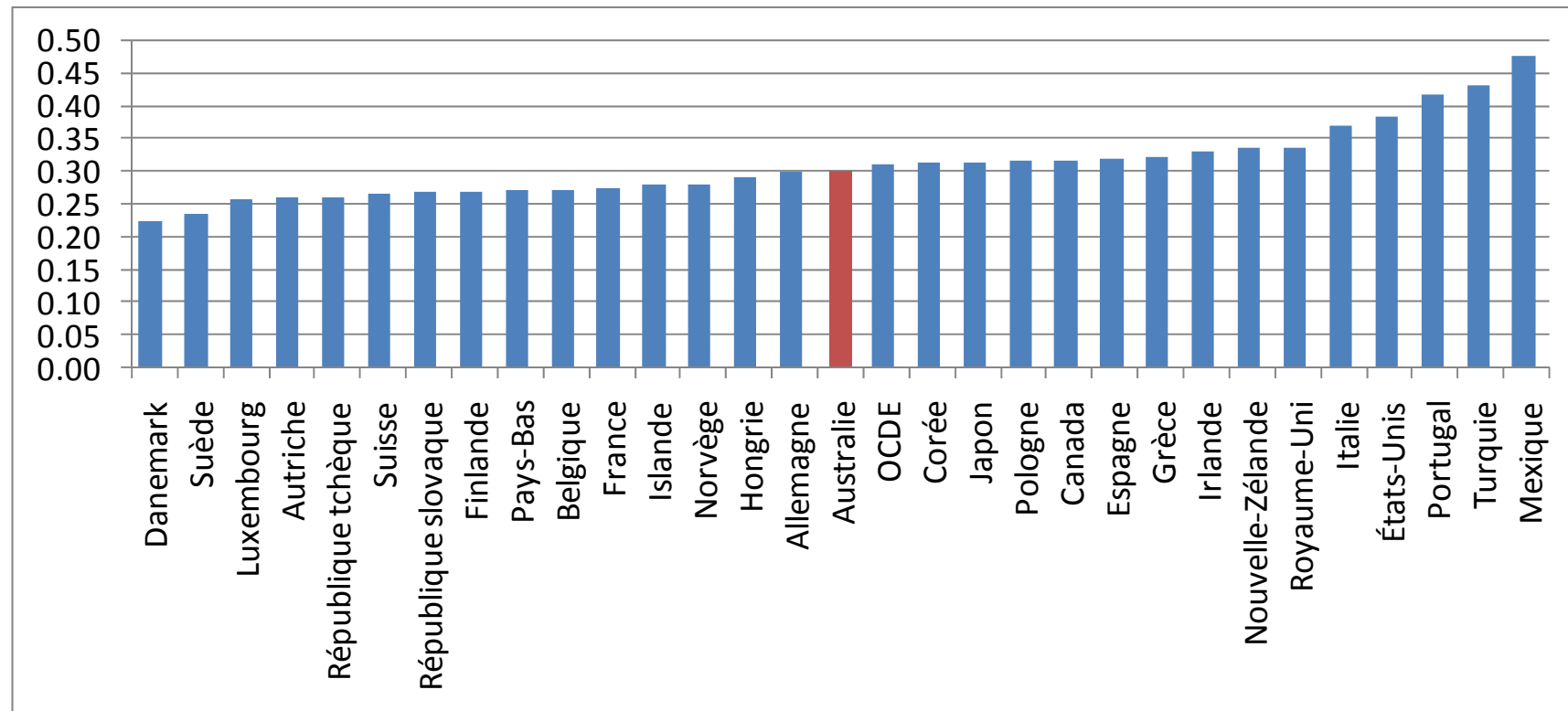
- Inequality among full-time male and female wage earners is around average for the OECD; including part-time workers significantly increases earnings inequality, but this is true for most OECD countries.
- Moving from individual to household earnings has a more significant effect.
  - The distribution of earnings of spouses is the most unequal in the OECD (individuals are ranked by household disposable income so this means that higher income primary earners are more likely to have high earner spouses). Gini coefficient for all full-time workers is around 0.28, that for full and part-time workers is around 0.35 and that for household earnings is around 0.40.
- Including working-age households where no-one is in paid employment significantly raises inequality.
  - Australia has the eight lowest non-employment rate for working age individuals, but the fifth highest joblessness rate for households, and for households with children the fourth highest joblessness rate. Inequality of household earnings including households with no earnings is the second highest in the OECD with the Gini coefficient at around 0.47.
  - To more effectively reduce inequality then it is unequal access to paid work that needs to be addressed, particularly the concentration of joblessness (not the overall level of joblessness).



## **ADDITIONAL MATERIAL**

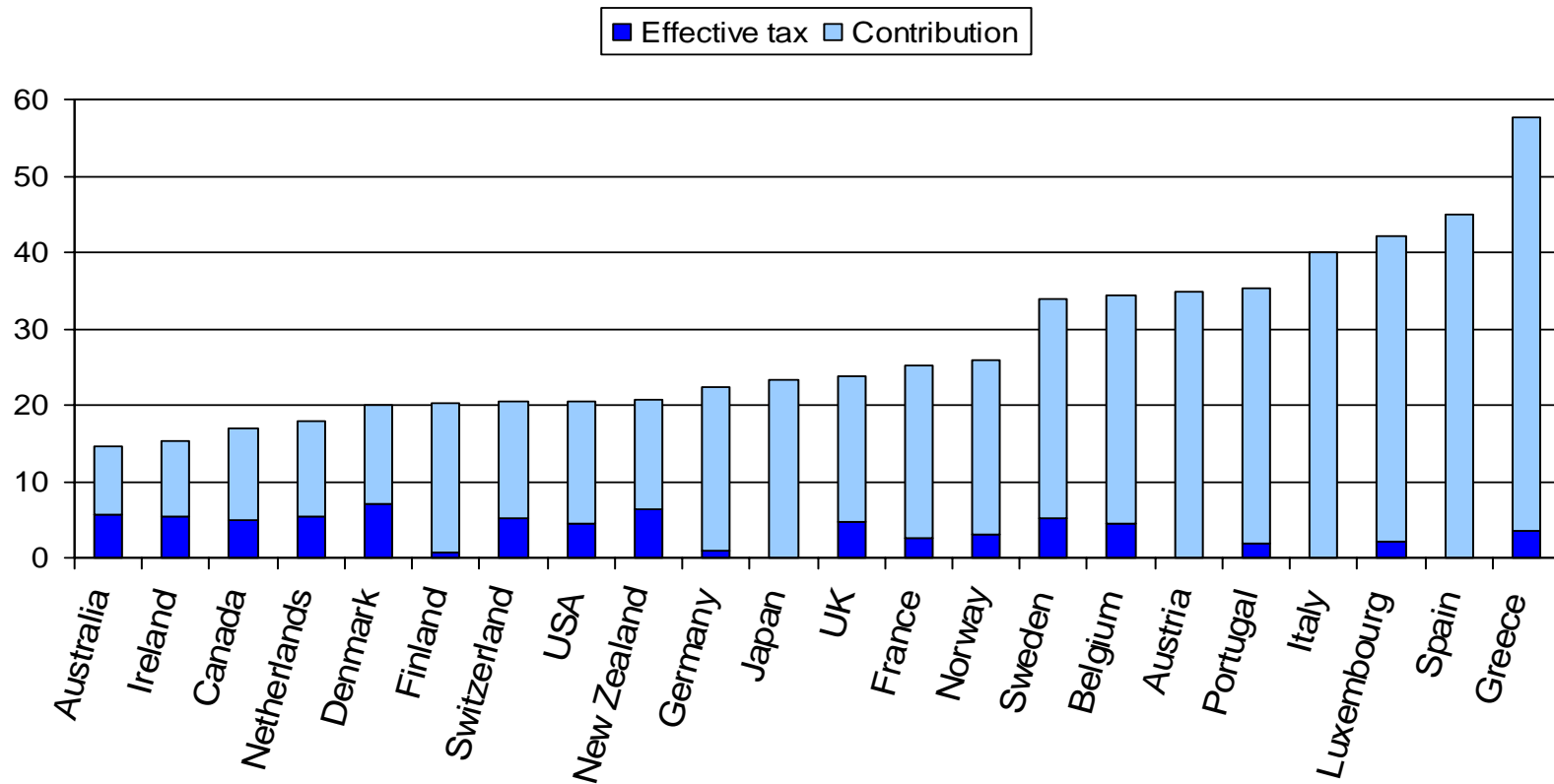
# Levels of inequality, OECD countries, 2005

Gini coefficient for disposable income



# Effective contributions to public pensions, redistributive and actuarial components, mid-1990s

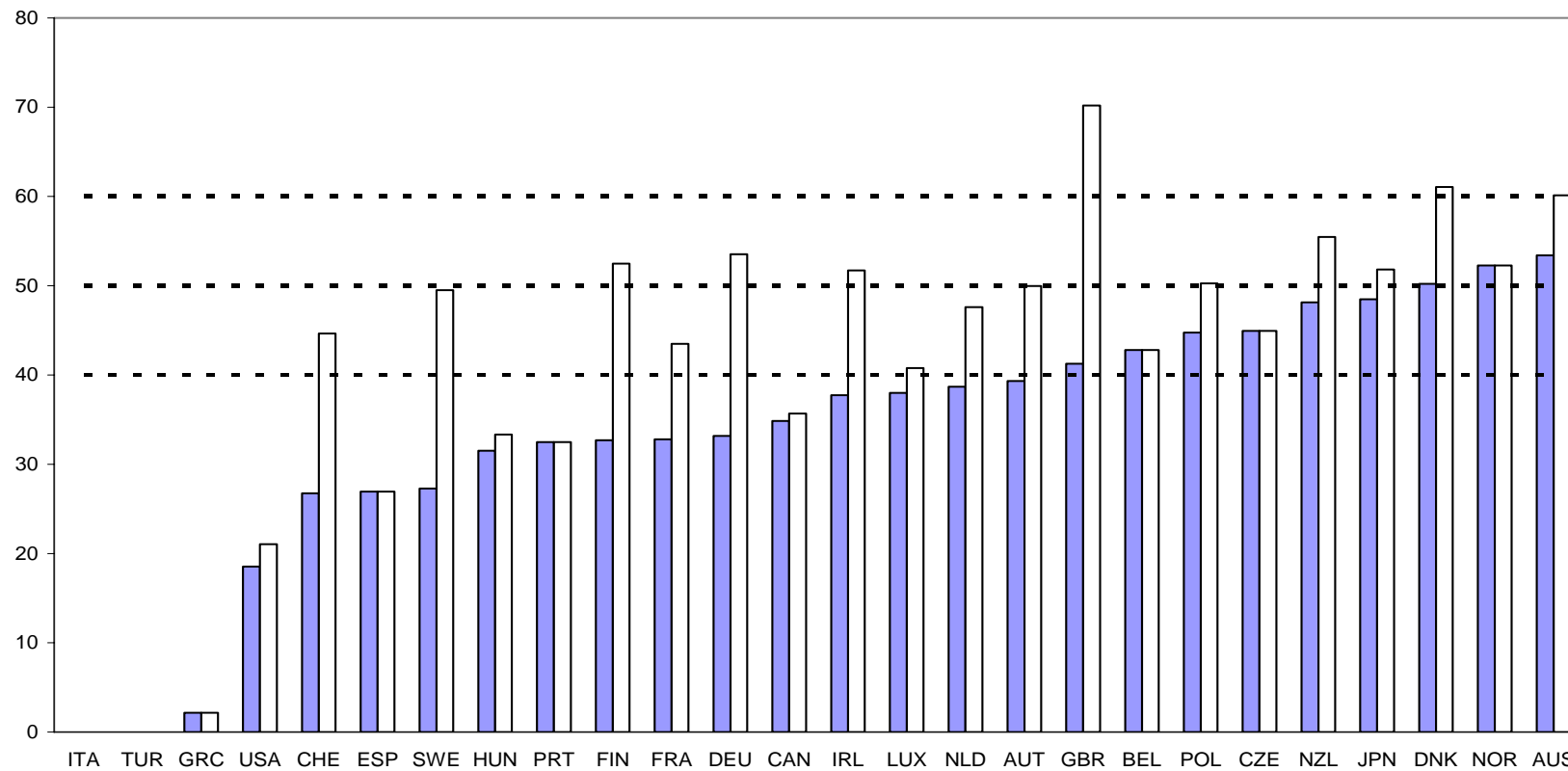
% of wages



# Net incomes of social assistance recipients, 2005

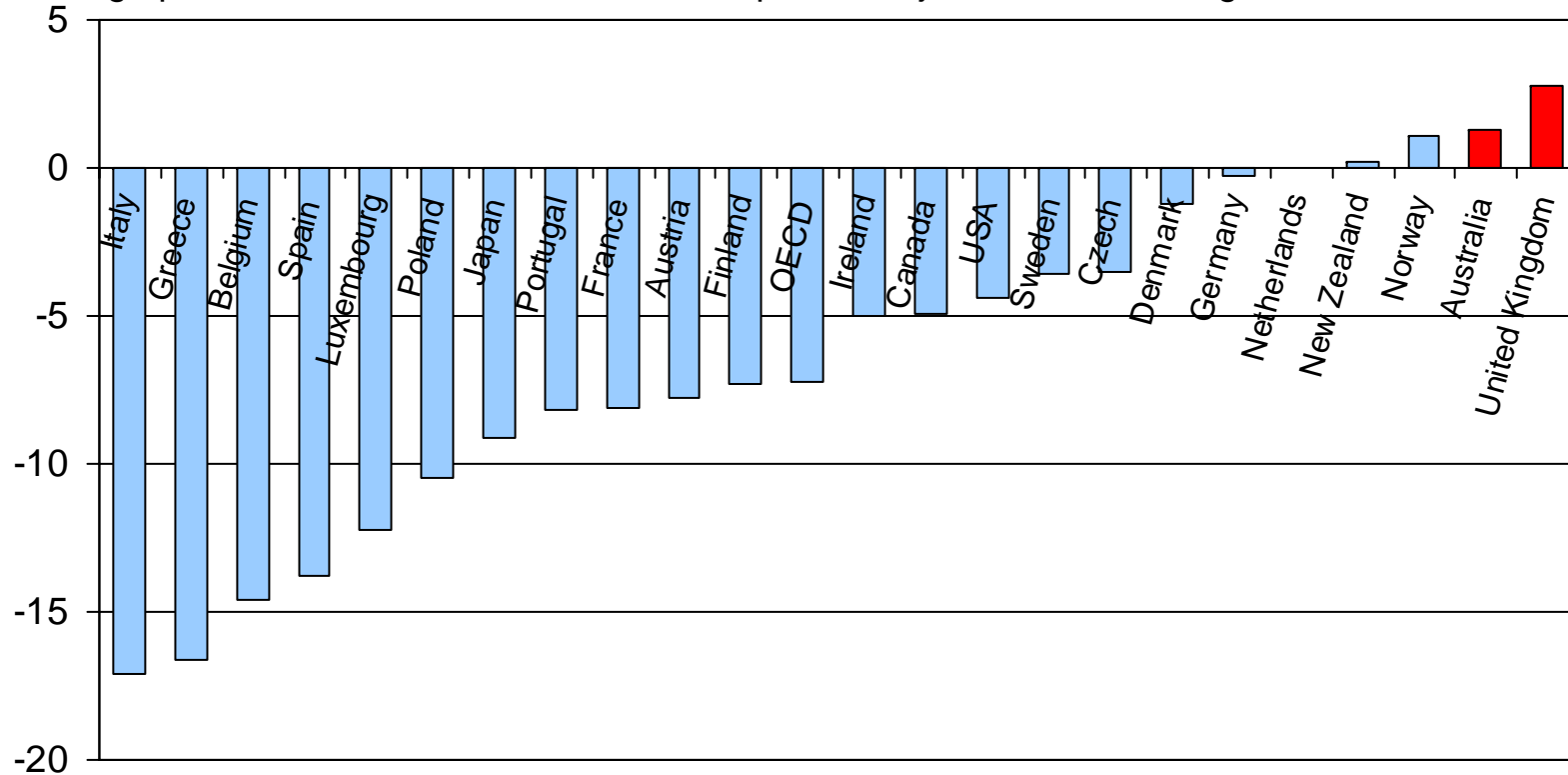
% of median equivalent household income, with and without housing benefits

## Lone parent, two children



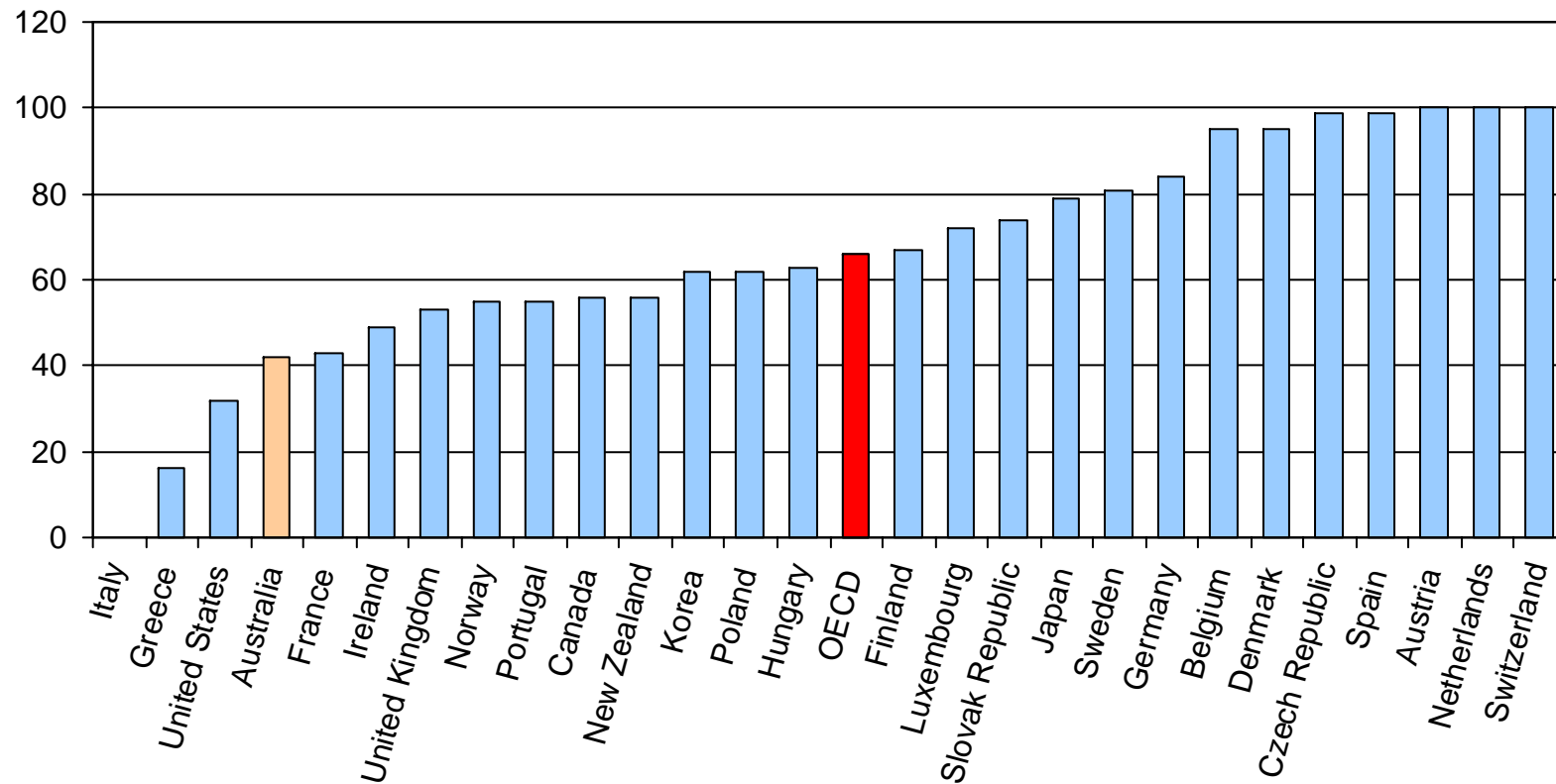
# Relative to their high overall employment, the UK and Australia do worst for joblessness among families with children

Percentage point difference between actual and predicted joblessness among families with children



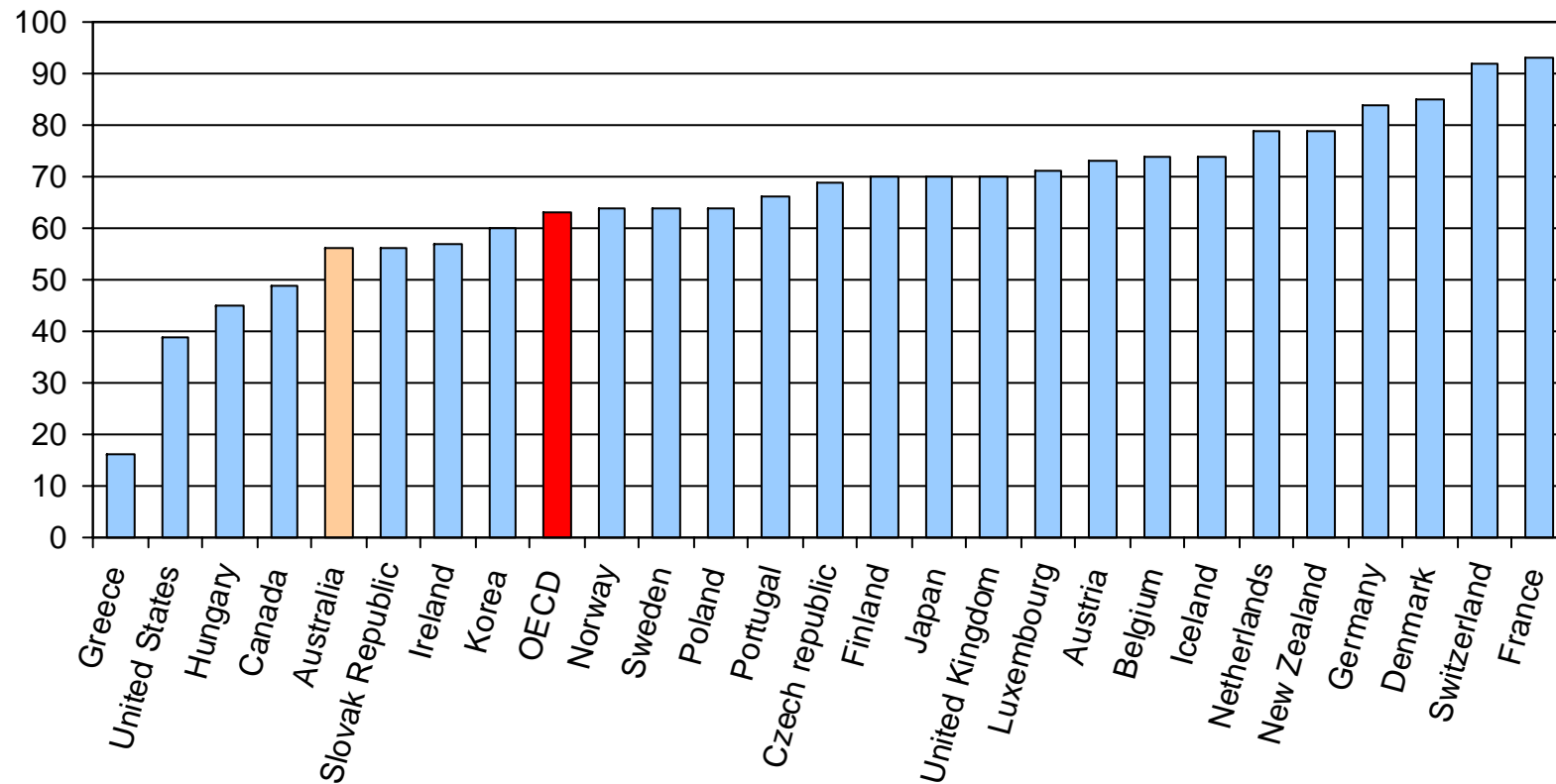
# Effective tax rates for parents seeking part-time work are lower in Australia than most other countries

AETR from zero to 33% APW, 2004



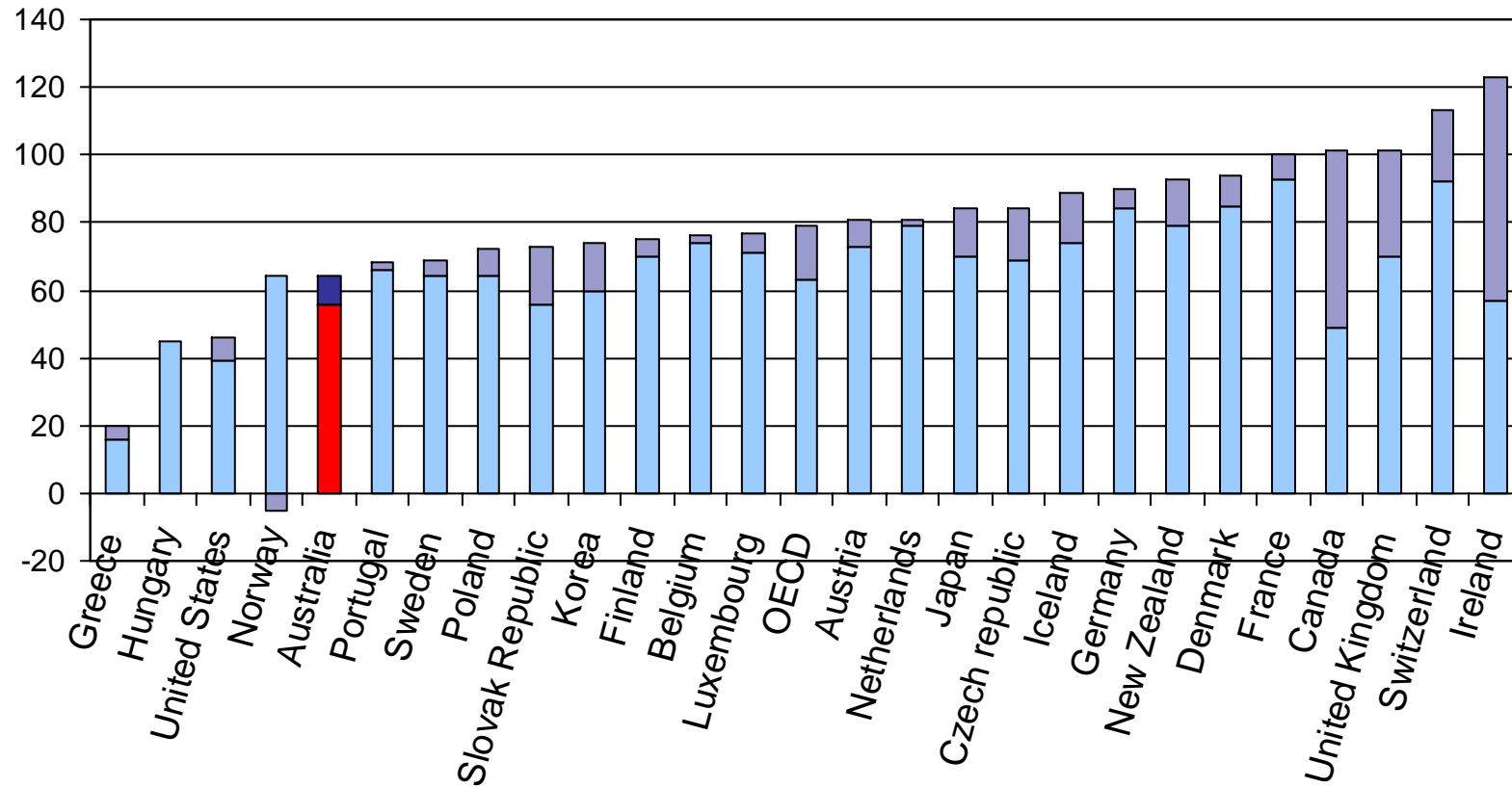
# Effective tax rates can be high for parents seeking full-time work, but are lower in Australia than most other countries

AETR from zero to 67% APW, 2004

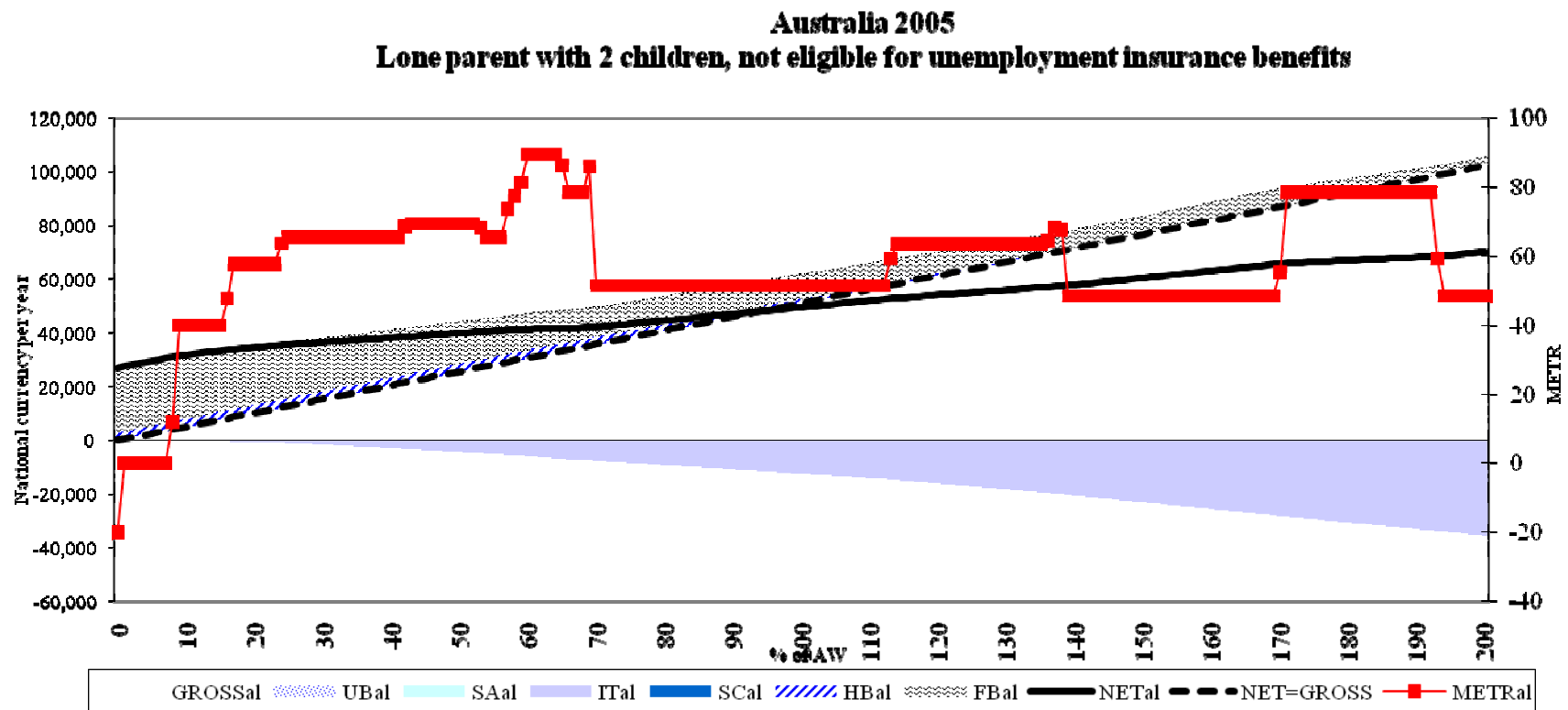


# Child care costs can increase effective tax rates

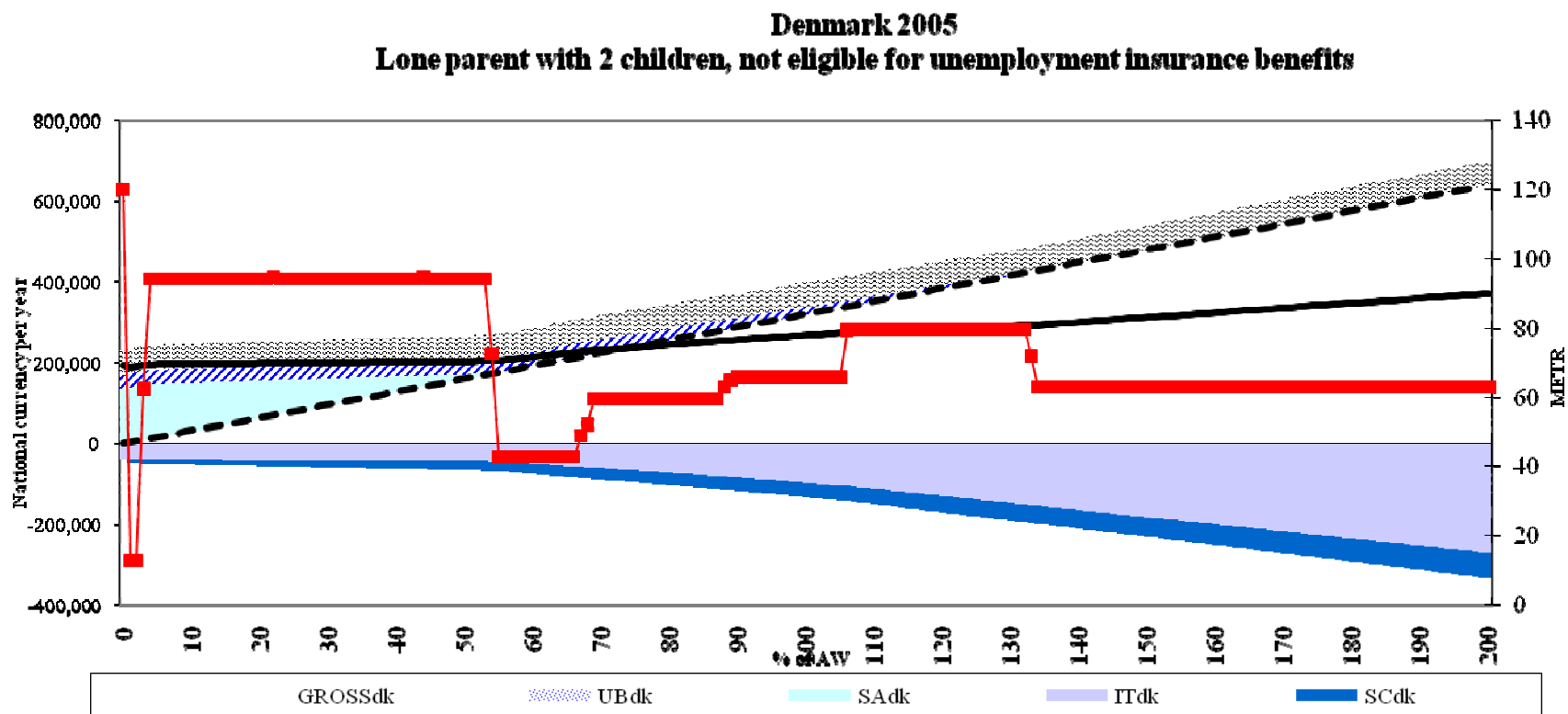
AETR from zero to 67% APW, plus child care costs, 2004



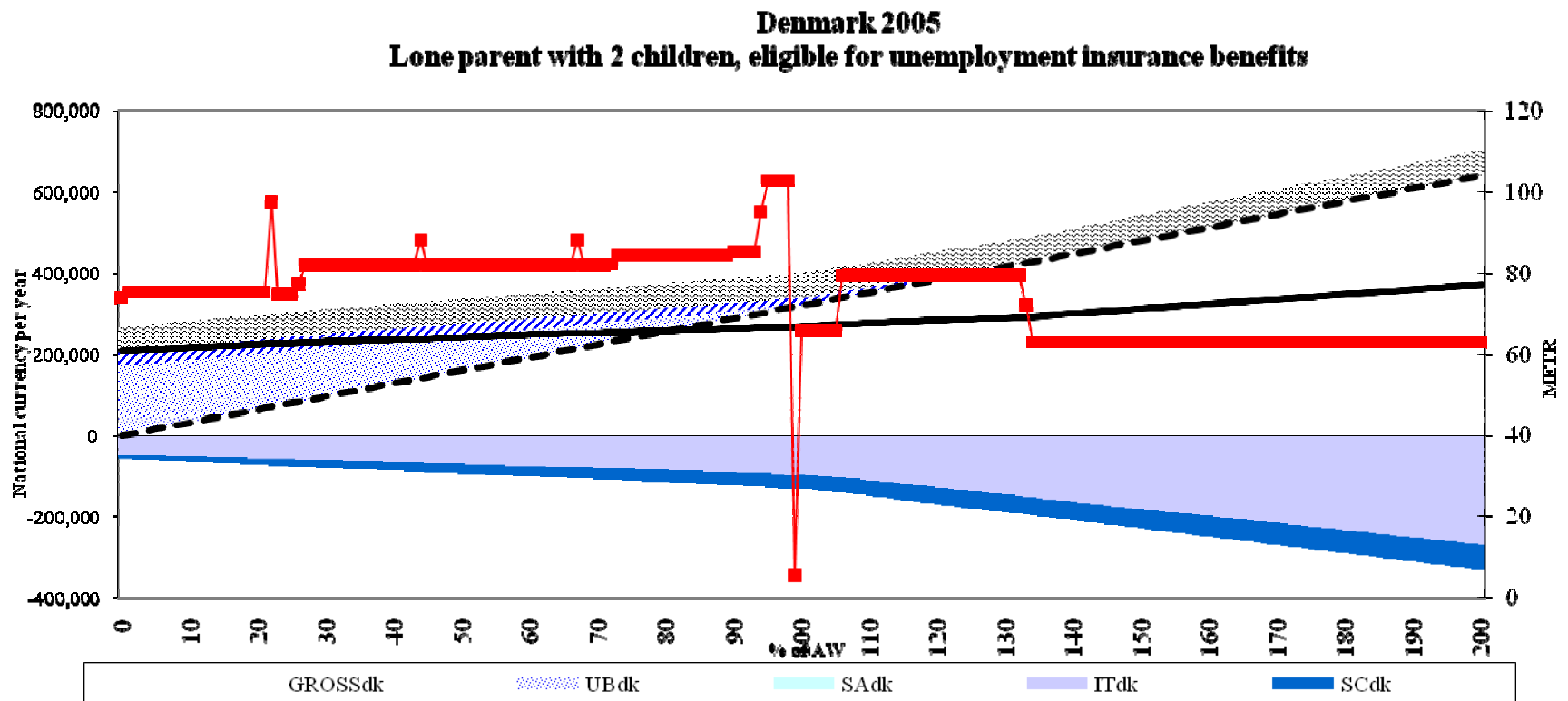
# Effective marginal tax rates can be high in Australia but over specific income ranges



# In contrast, the Nordic approach has much higher EMTRs at lower income levels



# Social insurance does not necessarily reduce EMTRs (for lone parents and single people)





# Sources

- OECD Family database -  
[www.oecd.org/els/social/family/database](http://www.oecd.org/els/social/family/database)
- OECD Social Expenditure database -  
[http://www.oecd.org/document/2/0,2340,en\\_2649\\_33933\\_31612994\\_1\\_1\\_1\\_1,00.html](http://www.oecd.org/document/2/0,2340,en_2649_33933_31612994_1_1_1_1,00.html)
- Net Social Expenditure – Adema and Ladaique (2005) -  
[http://www.oecd.org/findDocument/0,2350,en\\_2649\\_33933\\_1\\_119684\\_1\\_1\\_1,00.html](http://www.oecd.org/findDocument/0,2350,en_2649_33933_1_119684_1_1_1,00.html)
- OECD, Benefits and Wages -  
[http://www.oecd.org/department/0,2688,en\\_2649\\_34633\\_1\\_1\\_1\\_1,00.html](http://www.oecd.org/department/0,2688,en_2649_34633_1_1_1_1,00.html)
- OECD study of income distribution (2005) -  
<http://www.oecd.org/dataoecd/48/9/34483698.pdf>
- Benefit reciprocity - Employment Outlook (2003)
- OECD Social Indicators -  
[http://www.oecd.org/department/0,2688,en\\_2649\\_34637\\_1\\_1\\_1\\_1,00.html](http://www.oecd.org/department/0,2688,en_2649_34637_1_1_1_1,00.html)