

Transfer Issues and Directions for Reform: Australian Transfer Policy in Comparative Perspective

Peter Whiteford*

3.0 Introduction

The redistribution of income through taxes, transfers and public services is a central activity of government in all developed countries. The importance of looking at the taxation and transfer systems together has long been recognised in Australia (Podger, Raymond & Jackson 1980). The rationale for this is threefold: taxation is the source of financing for social welfare spending and correspondingly welfare spending is one of the most significant uses to which tax revenues are dedicated¹; the taxation and transfer systems are the two main instruments used by governments to achieve distributional outcomes; and the tax and transfer systems overlap and can reinforce or offset each other, with implications for incentives to work and save, and for household formation and other behaviour.

It has also long been recognised that the objectives of the welfare state can be achieved through a range of different instruments. Titmuss (1955) identified several different kinds of distributive mechanisms, arguing that it was not possible to understand the impact of government social policy without taking these alternative approaches fully into account. He referred to the 'social division of welfare', including three main types of welfare: social welfare (the social services including cash benefits); fiscal welfare (welfare distributed directly or indirectly through the tax system); and, occupational welfare (welfare provided as part of employment). This classification could be extended to include legal welfare (redistribution through the courts), and benefits and services provided by the voluntary sector and the informal sector (Rose 1981) as well as some types of self-provision, but the main underlying idea was to look beyond conventional definitions of the welfare state as programs directly provided or funded by government, to identify the different patterns of redistribution provided through alternative mechanisms, and to explain that different kinds of programs (e.g. assistance either provided through tax credits or as cash transfers) can have similar effects in some cases, or offsetting effects in others (Sinfield 1979; Mann 2008).

In analysing the effects of tax and transfer policies, an important area of debate is whether the redistributive and other goals of government can be achieved more efficiently and effectively through alternative policies. Consideration of these issues is central to the terms of reference of the

Review of Australia's Future Tax System. The objective of this chapter is to throw light on the effectiveness of the Australian transfer system through a range of comparisons with the design features of transfer systems in other OECD countries and the outcomes apparently associated with these differing designs.

This chapter also discusses how assessments of policy effectiveness are influenced by the broader welfare environment referred to above. In particular, I argue that it is necessary to take a comprehensive approach to defining the scope of the welfare state, since different countries use different combinations of instruments to achieve their objectives. Taking account of only one set of policy instruments, therefore, can lead to incorrect assessments of welfare state outcomes, including measures of spending, distributional outcomes and incentive implications.

As a starting point, it is important to note that the Australian institutional context differs in important respects from the situation in other countries. In most countries of Europe, as well as in the United States and Japan, most government benefits are financed by contributions from employers and insured employees, and benefits are often related to past earnings, so that higher income workers receive higher absolute levels of benefits if they become unemployed or incapacitated or when they retire. In contrast, in Australia and New Zealand, most government benefits are flat-rate entitlements financed from general government revenue, so that there are no explicit social security taxes. In addition, in both countries—but more so in Australia—most benefits are income tested or asset tested, so that entitlements reduce as resources increase. The usual rationale for this approach is that it provides the most efficient means of reducing poverty, by concentrating available resources on the poor ('helping those most in need'), while minimising adverse incentive effects by limiting the overall level of spending and taxes.

As will be demonstrated below, the transfer design features of the Australian system have resulted in the most targeted system of cash transfers in the OECD (and one of the most progressive systems of direct taxes in the OECD). The obvious questions to be asked therefore are: how effective is the Australian system of transfers and taxes in reducing poverty and inequality, and whether this approach is effective in minimising disincentives? Put simply, does targeting work?

* This analysis draws on work with former colleagues at the OECD, particularly Willem Adema, Michael Förster, David Grubb, Herwig Immervoll, Maxime Ladaique, Marco Mira D'Ercole and Mark Pearson. I am grateful for comments from Rob Bray, Chris Deeming, Chris Foster, Lane Kenworthy and David Stanton. However, the views expressed are my own, and I am responsible for any errors.

¹ Social spending accounts for between 40 per cent and 65 per cent of total government spending in all OECD countries (apart from Korea), and just under 50 per cent in Australia.

In other words, how effective is the system at reducing inequality and poverty, and does it minimise disincentives?

To contribute to clarifying these issues, this chapter presents results providing the most up-to-date comparative information on the relative size and performance of Australian welfare arrangements. We discuss: (a) trends in the level of public and private social expenditure in Australia compared to other OECD countries; and explanations for differences across countries; (b) the design features of transfer systems and the progressivity of the distribution of benefits, including the degree of 'churning' of benefits, the extent of 'middle class welfare', and the distribution of benefits over the lifetime; (c) the impact of taxes and transfers on income inequality and the position of low income groups; (d) the relative generosity of benefit entitlements; and (e) broad patterns of effective marginal tax rates associated with differing transfer systems. The chapter concludes with a discussion of possible implications of these findings for Australia's future tax and transfer systems.

A number of caveats should be emphasised. First, this chapter concentrates on cash benefits and direct taxes (although the discussion of spending data includes health care and a range of services). In analysing the distributional impact of the welfare state in the main part of the chapter, no account is taken of the impact of health services or other non-cash benefits such as child-care, education or active labour market programs²; nor is account taken of the impact of indirect taxes. This reflects the relative paucity of studies making international comparisons of these policies, as well as the fact that the impact of these policies cannot be routinely evaluated with data collected in household income surveys but requires additional modelling and imputation. In general, national studies that analyse the impact of non-cash benefits and indirect taxes all tend to find that income inequality and poverty are lower using these broader measures than in analyses restricted to cash benefits and direct taxes. Non-cash benefits tend to be less progressive than targeted or universal cash transfers, and more progressive than earnings-related benefits—but vary in levels of spending by less than cash benefits.³ In contrast, consumption taxes tend to be regressive by income, and are also much higher in high spending welfare states than in lower spending welfare states. Taking account of consumption taxes therefore increases inequality but narrows dispersion of outcomes. While the Nordic countries remain the least unequal after broadening the income

concept, and Mexico, Turkey and the United States remain the most unequal, Australia again improves its rank.⁴

Second, this chapter is primarily descriptive, and it focuses on what the Australian Treasury (2008) has called the architecture of the system. The approach adopted in this investigation is to use 'statistical calculations', in the sense used by Piggott (1987). This means, for example, that the assessment of the impact of alternative tax and transfer systems is essentially static and based on a linear accounting framework which assumes that the distribution of market incomes is unaffected by the size or design of the welfare state. Related to this is the fact that some important government activities affect 'market incomes' before taxes and transfers, but are unavoidably treated as if they are the result of market processes; most notable of these is the setting of minimum wages.⁵ The discussion identifies the limitations of this approach and also presents estimates that partly correct for some of these limitations.

Third, in presenting these results we do not look in detail at the significant conceptual and measurement problems involved in making international comparisons and achieving data consistency over time. It is important to note that inevitably the various sources drawn on are not necessarily consistent in their definitions of key variables. For example, spending data are derived from administrative sources and national accounts data, while data on the distribution of transfers and taxes are derived from household surveys so that, for example, actual spending on cash transfers includes amounts going to people in institutions who are outside the scope of household surveys, which are also subject to sampling and reporting errors. The household surveys themselves are not the same over time; for example, earlier results for Australia (Whiteford 2006) are drawn from the Household Expenditure Surveys, while the most recent results are derived from the Surveys of Income and Housing. While the results of these surveys should not be directly compared, it is worth noting that the findings on the progressivity of benefits, for example, are unaffected by this switch in data sources. Again, the effects of tax expenditures are included in household surveys in the observed distribution of taxes, but they cannot usually be separately identified. This chapter also presents results from tax-benefit models which show households' entitlements to receive transfers and their obligations to pay taxes and which therefore can differ from observed transfers and taxes because of errors in reporting income, incomplete take-up

2 Near-cash benefits such as Food Stamps in the United States and Housing Benefit in the United Kingdom are included in income surveys, however.

3 A recent comparative study (OECD 2008) finds that on average the inter-quintile income ratio is reduced by around one-third when the imputed value of non-cash public services is added to disposable income, with the effect tending to be stronger in countries with higher levels of disposable income inequality. While the dispersion of outcomes is narrowed, the ranking of most countries is unaffected, although some countries including Australia and France improve their position (OECD 2008, pp. 242–3).

4 A study by Warren (2008) finds that consumption taxes have a regressive impact on the distribution of household income, and that deducting these taxes from cash disposable incomes would increase the Gini coefficient in Australia by around 5 per cent (i.e. the Gini coefficient would be 0.313 rather than 0.300), while the relative effect would be smaller in Mexico, Japan and the United States, but larger in all other OECD countries, with the largest effects being in the Nordic countries, particularly Denmark, where the Gini coefficient would rise by around 18 per cent. These results should be considered illustrative rather than definitive, as estimates are based on grouped data and the estimated distributional impact of consumption taxes is based on the assumption that the incidence of consumption taxes in all countries is the same as in Australia (Warren 2008).

5 An illustration of the complexities of these issues is raised by Australia's early experience with minimum wages; the Harvester case of 1907 set the basic wage of the time as being sufficient for a worker to support a dependent spouse and three children. Over the course of time, support for dependents was moved from the wage system to the tax and transfer systems.

of benefits or tax avoidance. All that can be claimed is that being well aware of these and other problems, the methodologies used in this chapter are designed to produce results that are as comparable as is possible.

Fourth, this chapter mainly refers to the situation around 2005 rather than currently, with the discussion of spending levels relevant until 2005, and the main analysis of the distribution and effects of benefits and taxes also being around 2005 (2003–04 in Australia). This is the most up-to-date data available, but economic conditions have obviously changed significantly since 2005. Selected estimates of distributional impacts going back to the 1980s are also provided to identify the extent of continuity in these measures of transfer design and outcomes.

3.1 Social Spending in OECD Countries⁶

3.1.1 Defining and Measuring Social Spending

The OECD (2008) defines social expenditure as follows:

The provision by public and private institutions of benefits to, and financial contributions targeted at, households and individuals in order to provide support during circumstances which adversely affect their welfare, provided that the provision of the benefits and financial contributions constitutes neither a direct payment for a particular good or service nor an individual contract or transfer.⁷

A comparison of the level of social spending is one of the most common ways of comparing welfare states. Spending is often seen on the one hand as an indicator of 'generosity' or at least of 'welfare effort', or on the other hand, as an indicator of costs or burdens. As Howard (2003) observes, 'The prevailing wisdom is easy to summarise. The size of welfare states is measured in the literature by the share of gross domestic product (GDP) devoted to public social spending, which is sometimes referred to as a nation's welfare state effort'.

As noted by Ingles (1977) and Gruen (1982), however, differences in apparent levels of social spending across countries are associated with a range of factors that substantially complicate interpretation of whether spending is 'too high' or 'too low'. These factors include: problems of definition and measurement; differences in 'needs' in different countries; interactions with the taxation system; differences in the mix of instruments (public and private) in

different countries; differences in the structure of assistance, particularly the degree of targeting; and differences in household composition. As will be shown below, all of these factors have very significant impacts on assessments of relative levels of welfare state spending.

In particular, a number of recent OECD studies have shown that a narrow focus on *gross public spending* can be misleading as this ignores the important role of the tax system, through which governments can:

- » claw back financial support through direct and indirect taxation of benefit income;
- » directly provide support to households (e.g. child tax credits); and
- » encourage individuals and companies to provide social support (e.g. through favourable tax treatment of private pension contributions and earnings of fund assets or private health insurance coverage).

Accounting for the impact of the tax system on budgetary allocations with a social purpose leads to indicators of *net (after tax) public social expenditure*.

The conventional emphasis on direct public spending also ignores other forms of public provision, for example, when governments mandate employers to provide pension coverage or sickness insurance, or when governments regulate the conditions of private health insurance coverage. Furthermore, the private sector, including individuals, can also provide social benefits voluntarily which top-up government regulated provisions. Frequently these benefits are related to collective labour agreements and are subject to favourable tax treatment.

Overall, a comprehensive assessment of total welfare provision means that it is necessary to capture the additions to and subtractions from public spending that are effected through the tax system, as well as the additional support provided through mandatory or voluntary private social spending. Such a comprehensive approach facilitates measuring the total share of an economy's domestic production that recipients of social benefits draw on: *net total social expenditure* (Adema & Einerhand 1998; Adema & Ladaïque 2005; OECD 2009).

As noted, social benefits to households and individuals can be publicly or privately provided. They are considered 'public' when relevant financial flows are controlled by general government (i.e. central, state, and local governments, including social security funds). Thus, benefits

6 Social protection spending is defined by the OECD to include cash benefits, welfare services and public health spending, but not public education, and covers all levels of government. Social spending is categorised as follows: *old-age*—pensions, and home-help and residential services for the elderly; *survivors*—pensions and funeral payments; *incapacity-related benefits*—disability benefits and services, employee sickness payments; *health*—spending on in- and out-patient care, medical goods, and prevention; *family*—child allowances and credits, child-care support, income support during leave, sole parent payments; *active labour market policies*—employment services, training, youth measures, subsidised employment, employment measures for the disabled; *unemployment*—unemployment compensation, early retirement for labour market reasons; *housing*—housing allowances and rent subsidies; and, *other contingencies*—other support measures such as non-categorical cash benefits to low-income households, or support programs for substance abusers, legal aid, etc. There is no international agreement on whether marriage support is a social policy objective or not, and fiscal support towards married couples is not included. Data on social spending is available in OECD (1976, 1985 and 1996) and Varley (1986) and OECD (2009) on the OECD website, with data up to 2005. See <http://www.oecd.org/document/9/0,3343,en_2649_34637_38141385_1_1_1_1,00.html>. It is important to note that the definitions of social spending are not consistent across these various publications, but each new edition of the data is updated and provides a consistent series from 1980 onwards.

7 This social expenditure definition only covers benefits provided by institutions, not transfers between households even though they may be of a social nature. Also, social expenditure does not include remuneration for work, as it does not include payments in return for the simultaneous provision of services of equivalent value. Employer costs such as allowances towards transport, holiday pay, or severance payments before the standard retirement are therefore not included.

(partly) financed out of social security contributions paid by employers to social security funds are within the public sphere. Also, in line with the National Accounts (SNA 1993), the OECD Social Expenditure database (SOCX) counts pensions paid to former civil servants through autonomous funds as a private spending item in Australia (partly⁸), Canada, Denmark, the Netherlands, Sweden and the United Kingdom.

All social benefits *not* provided by general government are considered 'private'. Private social benefits can be categorised in two broad groups:

- » mandatory private social benefits, including legally stipulated employment-related cash transfers related to incapacity, such as sickness, disability and occupational injury benefits (recorded in Australia, Austria, Denmark, Finland, Germany, Iceland, Korea, the Netherlands, Norway, the Slovak Republic, Sweden, the United Kingdom, and in some US states); mandatory employer-provided retirement allowances (e.g. severance payments in Italy and Korea); and, pensions derived from mandatory (individual and/or employer) contributions (Australia, Switzerland);
- » voluntary private social expenditure, for example, social services provided by NGOs, employer-provided (perhaps on basis of a collective agreement) income support during child-related leave or sickness, and pensions derived from employer contributions (in many OECD countries) or fiscally advantaged individual contributions (Individual Retirement Accounts in the United States).

Expenditure programs are considered 'social' if participation is compulsory, or if entitlements involve inter-personal redistribution of resources. Public social services, social insurance and social assistance benefits are either financed through general taxation or social security contributions, and therefore involve the redistribution of resources across the population in general or within population groups (e.g. all members of a sickness insurance fund). Many private benefits are provided under the influence of government actions. Indeed, inter-personal redistribution in private programs is often induced by government legislation (e.g. through requiring insurance companies to have one price for the same policy for both sick and healthy people), or, as in many OECD countries, through favourable tax treatment to stimulate take up of private pensions. Governments sometimes also influence the collective bargaining process that may lead to employer-provided support for workers during sickness or child-related leave periods or for child-care support (OECD 2007). Government intervention introduces and/or enhances redistribution among population groups participating in

private programs, which leads to a high degree of similarity between legally-stipulated private arrangements and tax-advantaged plans.

3.1.2 Levels of Gross Public Spending

Table 3.1 provides a detailed breakdown of spending by main components in 2005, and this is illustrated in Figure 3.1. In terms of gross spending, the lowest levels were in Korea and Mexico, which spent around 7 per cent of GDP; Australia was the ninth lowest spender and fell into a disparate group spending between 13 per cent and 20 per cent of GDP, including Turkey, the United States, Japan, Canada, the Czech and Slovak Republics, New Zealand, Iceland and Ireland. A further ten countries clustered at spending levels between 20 per cent and 25 per cent of GDP. At the highest level of gross spending there is another disparate group of countries, with Italy, Finland, Belgium, Germany, Denmark, Austria, France and Sweden spending between 25 per cent and 30 per cent of GDP. For all OECD countries, the unweighted average level of spending in 2005 was 20.5 per cent of GDP, with Australia spending 17.1 per cent of GDP, or about 83 per cent of the OECD average.⁹

How specifically is Australia different? Most components of welfare spending in Australia are below the OECD average, except spending on disability benefits and services, which is just above the average, and spending on families, which is about 40 per cent above the average. Public spending on health care in Australia is only slightly below the OECD average. In term of composition, the main explanation for Australia's difference from the OECD average is relatively low spending on pensions and services for the aged. Spending on the aged—even though it is the most significant cash benefit in Australia, as in most other OECD countries—was only around 60 per cent of the OECD average, with only Mexico, Ireland, Korea, New Zealand and Canada spending less. Some of this discrepancy is due to differences in demographic composition, as the share of people over 65 in the total Australian population is about 11 per cent below the OECD average, but mainly it is due to the design features of Australian age pensions (being flat rate and means tested rather than earnings related). Other spending categories—survivors, housing and low income—are smaller fractions of the OECD average, but involve low levels of spending in most countries.

As noted, gross spending on families in Australia was apparently 1.4 times the OECD average, with only ten countries (Austria, Denmark, Finland, France, Hungary, Iceland, Luxembourg, Norway, Sweden and the United Kingdom) spending more on benefits and services for

8 Australian pension arrangements for former civil servants constitute a hybrid of public and private components. The relevant pension payment is a defined benefit scheme which is guaranteed by the government and thus classified as public. In contrast, the lump sum payment which many civil servants take on retirement is based on their compulsory contributions and investment returns and this spending is grouped under mandatory private social expenditure for Australia.

9 Following convention, this discussion uses the unweighted average for OECD countries. It could be argued that it would be more appropriate to use the weighted average; for example, weighted by GDP the OECD average level of social expenditure in 2005 was around 18 per cent of GDP rather than 21 per cent. The main reason for this difference is that the two largest OECD economies—the United States and Japan—spend less than the OECD unweighted average and less than Australia. However, as discussed in section 3.1.3, on other measures of net public and private welfare spending the United States actually spends more than Australia.

families with children. However, a good deal of spending on families in some of these countries is spending on child-care, maternity and parental leave, where Australia spends relatively little. Counting only spending on cash benefits to families with children then Australia spends around 1.7 times the OECD average (equal third-highest), and twenty times what is spent in the United States or seven times what is spent in Japan, for example.¹⁰ To a minor extent this can be explained by differences in demographic structure: the share of children in the total population is about 6 per cent above the OECD average.

The most important reason why Australia appears to spend a relatively high amount on benefits for families, however, is because assistance that used to be provided through the tax system before 1975 is now paid mainly through cash benefits. Many other countries continue to provide assistance to families through the tax system, for example, France, Germany, the United Kingdom, the Netherlands, Japan and

the United States, and in some cases this is substantial, amounting to between 0.7 per cent and 0.9 per cent of GDP in France, Germany and the United States. When tax breaks for families are included Australia drops from tenth to thirteenth place in the OECD.

3.1.3 Net Social Expenditure

The discussion above has concentrated on levels and trends in 'gross' social spending, but the discussion of assistance for families highlights the point made at the beginning of this chapter that it is necessary to take a broad approach to measuring social spending. A number of recent OECD studies have fundamentally changed our understanding of the real size of social spending (Adema et al. 1996; Adema 2001; Adema & Ladaique 2005). The main implication of these studies is that accounting for private social benefits and the impact of the tax system on social expenditure has a significant equalising effect on levels of social effort

Table 3.1 Composition of Spending on Social Protection, OECD Countries, 2005, Per Cent of GDP

	Age	Survivors	Disability	Health	Family	Unemploy- ment	ALMP	Housing	Other	Total	Cash benefits	Services*
Australia	4.4	0.2	2.4	5.9	2.8	0.5	0.4	0.3	0.1	17.1	8.1	3.1
Austria	12.6	0.4	2.4	6.8	2.8	1.1	0.6	0.1	0.3	27.2	18.4	2.0
Belgium	7.2	2.0	2.3	7.3	2.6	3.3	1.1	0.1	0.4	26.4	16.2	2.9
Canada	3.7	0.4	0.9	6.8	1.0	0.6	0.3	0.4	2.2	16.5	6.8	2.9
Czech Republic	7.5	0.2	2.4	6.3	1.7	0.6	0.3	0.1	0.4	19.5	11.4	1.8
Denmark	7.2	0.0	4.3	5.9	3.2	2.8	1.7	0.7	1.0	26.9	13.6	7.4
Finland	8.5	0.9	3.8	6.2	3.0	2.0	0.9	0.3	0.5	26.1	15.3	4.6
France	10.9	1.8	1.9	7.8	3.0	1.7	0.9	0.8	0.4	29.2	17.5	3.9
Germany	11.2	0.4	1.9	7.7	2.2	1.7	1.0	0.6	0.2	26.7	15.9	3.1
Greece	10.8	0.8	0.9	5.6	1.1	0.4	0.1	0.5	0.4	20.5	13.4	1.5
Hungary	8.8	0.3	2.8	6.0	3.1	0.6	0.3	0.5	0.1	22.5	13.6	2.9
Iceland	3.8	0.0	2.7	6.3	3.0	0.3	0.1	0.2	0.5	16.9	5.7	4.9
Ireland	2.9	0.8	1.6	6.5	2.5	0.9	0.6	0.5	0.3	16.7	8.4	1.8
Italy	11.6	2.5	1.7	6.8	1.3	0.5	0.6	0.0	0.0	25.0	16.7	1.5
Japan	8.6	1.3	0.7	6.3	0.8	0.3	0.3	–	0.3	18.6	10.2	2.1
Korea	1.5	0.2	0.6	3.2	0.3	0.2	0.1	–	0.7	6.9	2.9	0.8
Luxembourg	5.2	2.0	3.3	7.0	3.6	1.0	0.5	0.2	0.4	23.2	13.9	2.3
Mexico	1.0	0.3	0.1	2.9	1.0	–	0.0	1.1	0.5	7.0	2.0	2.1
Netherlands	5.5	0.3	3.6	6.0	1.6	1.5	1.3	0.3	0.6	20.9	11.1	3.8
New Zealand	4.2	0.1	2.9	6.9	2.6	0.4	0.4	0.8	0.2	18.5	9.7	1.9
Norway	6.3	0.3	4.4	5.8	2.8	0.5	0.7	0.1	0.6	21.6	10.9	4.9
Poland	10.4	1.0	2.7	4.3	1.1	0.5	0.4	0.1	0.4	21.0	15.7	1.0
Portugal	8.7	1.6	2.3	7.2	1.2	1.2	0.7	0.0	0.2	23.1	14.6	1.3
Slovak Republic	6.2	0.2	1.7	5.3	2.1	0.3	0.3	0.0	0.5	16.6	10.2	1.1
Spain	7.9	0.5	2.5	5.8	1.1	2.2	0.8	0.2	0.2	21.2	13.1	2.3
Sweden	9.6	0.6	5.6	6.8	3.2	1.2	1.3	0.5	0.6	29.4	14.5	8.1
Switzerland	6.6	0.4	3.3	6.1	1.3	0.9	0.7	0.2	0.7	20.3	11.8	2.4
Turkey	6.4	1.6	0.2	5.4	0.0	0.1	0.0	–	–	13.7	8.1	0.2
United Kingdom	6.1	0.2	2.4	7.0	3.2	0.3	0.5	1.4	0.2	21.3	10.3	4.0
United States	5.3	0.8	1.3	7.0	0.6	0.3	0.1	–	0.6	15.9	8.0	0.9
OECD	7.0	0.7	2.3	6.2	2.0	1.0	0.6	0.4	0.7	20.5	11.6	2.8
Australia/OECD	0.6	0.3	1.0	1.0	1.4	0.5	0.7	0.8	0.1	0.8	0.7	1.1
Difference	–2.6	–0.5	0.1	–0.3	0.8	–0.5	–0.2	–0.1	–0.6	–3.4	–3.5	0.3

Notes: * Services excluding health. Figures for Portugal refer to 2004. –: Data not available. OECD averages exclude countries where data are not available for related time series. ALMP: Active Labour Market Programs.

Sources: OECD (2009), Social Expenditure database (SOCX <<http://www.oecd.org/els/social/expenditure>>).

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

across OECD countries (Table 3.2). Broadly speaking, there are three instruments that governments use to manipulate social expenditure through the tax system, the impact of which varies across countries and can be considerable:

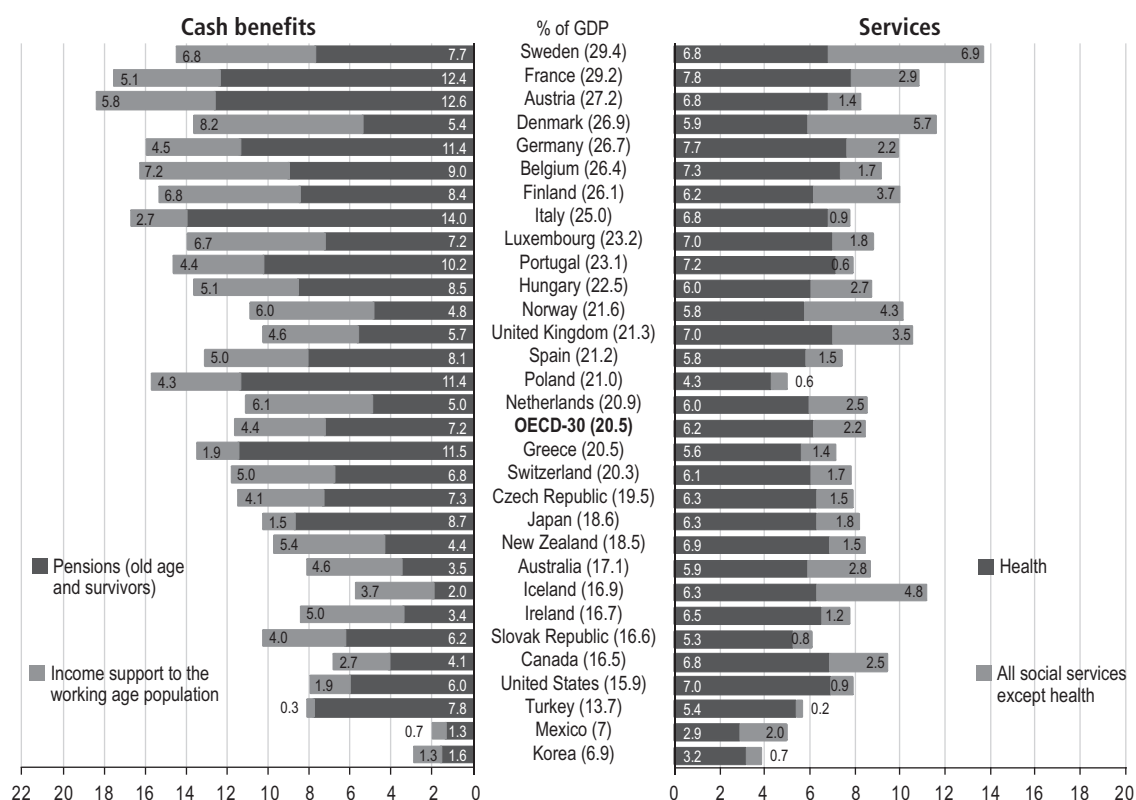
- » *Direct taxation (including social security contributions) paid on cash transfers* is close to or exceeds 2 percentage points of GDP in Austria, Belgium, the Netherlands, Norway and Poland. It is 3 per cent in Finland, and close to 5 per cent of GDP in Sweden and Denmark, but less than 0.5 per cent of GDP in Australia, the Czech Republic, Ireland, Japan, Korea, Mexico, the Slovak Republic, the United Kingdom and the United States (Table 3.2).
- » *Indirect taxation levied on goods and services bought by benefit recipients* is estimated to be much higher in European countries—over 3 per cent of GDP in Luxembourg and over 2 per cent of GDP in Austria, Belgium, Denmark, Germany, Finland, France, Italy, Norway and Sweden—than in non-European OECD countries—0.3 per cent of GDP in the United States, 0.7 per cent in Japan, 0.8 per cent in Canada and also in Australia.
- » *Tax breaks with a social purpose* (either tax advantages similar to cash benefits or tax concessions aimed at stimulating the provision of private social benefits, but not including support for pensions) are of limited

value in apparently high spending Nordic countries, but are worth close to 1 per cent or more of GDP in Canada, France, Japan, Mexico and close to 2 per cent or more in Germany and the United States (but only around 0.4 per cent of GDP in Australia).¹¹

Taking account of the role of the tax system substantially reduces net expenditures in many high spending welfare states, but has limited impact in Australia and actually increases spending in the United States, Canada, Mexico and Korea, and therefore generates greater similarity of spending totals across countries. Net public social spending in Denmark and Sweden is about 5–6 per cent of GDP below spending levels suggested by gross indicators, while for the United States, gross public social expenditure underestimates public social effort by more than 1 per cent of GDP. Net current social spending in Australia is around 0.6 per cent of GDP lower than gross spending; as a result, Australia moves from 83 per cent to 90 per cent of the OECD-26 average, but falls from eighth-lowest place to sixth-lowest place because of the narrowing dispersion of outcomes and because the United States and Canada jump from being below to above Australia.

In addition, Table 3.2 points to the important role played by mandatory private social expenditures. For example, income support for the sick in Australia is predominantly provided by employers through industrial

Figure 3.1 Public Social Expenditure by Social Policy Area, OECD Countries, 2005



Notes: Countries are ranked by decreasing order of public social expenditure as a percentage of GDP. Spending on Active Labour Market Programs (ALMPs) cannot be disaggregated by cash/services/fiscal support; but the aggregate is included in total public spending (shown in brackets). 2004 data for Portugal. Source: Adema and Whiteford, forthcoming.

11 The OECD analysis does not include tax expenditures on pensions because of the absence of fully comparable data across OECD countries and the fact that pension tax expenditures may benefit people in the future, whereas welfare spending benefits people now. Available data suggest that Australia has by far the highest level of pension tax expenditures in the OECD (Table 3.2).

awards that fall outside the definition of public spending, while in many other countries coverage is provided through the government social security system (Castles 1992). The Superannuation Guarantee is a further example of mandatory private spending. In 2005, net mandatory private social expenditure in Australia amounted to around 0.8 per cent of GDP, more than twice the OECD-26 average and the third-highest level in the OECD (exceeded by Italy and Iceland).¹²

In some regards, there appears to be a tradeoff between public and private social spending and between public provision and tax support/clawback, but this is not always the case. Most low public social spending countries like Australia levy little direct tax on benefit income, while high spending Nordic welfare states tend to levy high levels of direct and indirect taxes on benefits. But France and Germany are high social spending countries with a relatively limited direct tax burden on beneficiaries, which contributes to these two countries having the highest level of net total social expenditure as a per cent of GDP. Also as noted, France and Germany have high levels of tax expenditures to support families with children, but so do the United States and the United Kingdom. Australia, like the Nordic countries, has relatively low levels of such tax expenditures, but Australia has very high levels of pension tax expenditures.

Again, if only public spending on the aged is considered then Australia is very low in OECD rankings. For instance, Australia spends 3.2 per cent of GDP on cash benefits for older people compared to 6.5 per cent on average, and 12.2 per cent of GDP in Austria, the highest spending country. But mandatory and voluntary private pensions add 2.4 per cent of GDP to Australian spending and only 0.5 per cent to Austrian spending. The direct tax clawback on age pension is less than 1 per cent in Australia compared to close to 17 per cent in Austria, and the indirect tax rate on benefit income is just under 10 per cent in Australia compared to around 16 per cent in Austria. So while Australian gross public pension spending is only around 25 per cent of the Austrian level, net public and private spending is roughly 62 per cent of the Austrian level. Nor does this include the effects of pension tax expenditures, which would add close to 2 per cent of GDP to the Australian level of spending, but about one-twentieth of that amount to the Austrian level.

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

narrower than has been thought.¹³ In the case of Australia, this is mainly because very little is clawed back in taxes from benefit recipients, whereas in the Nordic welfare states taxation is the main instrument used to target spending.

3.1.4 Trends in Gross Public and Private Spending

Between 1980 and 2005, gross public social expenditure increased from 16 per cent to 20.5 per cent of GDP on average across OECD countries¹⁴ (Table 3.3). Experiences differ across OECD countries, but on average public social spending-to-GDP ratios increased most significantly in the early 1980s, the early 1990s and again in the early 2000s, when the average public spending-to-GDP ratio increased by 1.2 per cent of GDP from 2000 to 2005. Countries including the United Kingdom, Japan and the United States saw above average increases in gross public spending in recent years, while Australia and New Zealand saw some fluctuations but an overall decline.

In between these turning points, spending-to-GDP ratios changed little; during the 1980s the average OECD public social spending-to-GDP ratio fluctuated at just below 20 per cent of GDP, while during the 1990s it trended downwards after the economic downturn in the early 1990s, but nevertheless remained above 20 per cent of GDP. In most OECD countries, spending-to-GDP ratios in 2005 were well above 1980s levels, except in the Netherlands, where during the 1990s persistent economic growth, reductions in generosity and tightening of inflows into disability benefits, and the privatisation of sick pay led to a decline in public social spending by 4 per cent of GDP.

Figure 3.2 shows that in real terms, public social spending has grown faster than GDP across the OECD area as a whole since 1990, and for the major economic zones as well as in Australia, but particularly in Japan where real spending growth has outpaced sluggish real GDP growth since 1990, and the public social expenditure-to-GDP ratio has steadily increased from just over 11 per cent in 1990 to almost 19 per cent in 2005 (Figure 3.2). Figure 3.2 shows that real spending more than doubled in Australia after 1990, which was the sixth-highest increase in the OECD; it was mainly lower-income OECD countries that had higher real increases (Turkey, Mexico, Korea and Poland), but also two of the richest OECD countries (Ireland and Luxembourg). However, real GDP also increased strongly in Australia over this period—again being the sixth highest in the OECD, thus moderating the growth in public social spending relative to GDP.

The two key drivers of increases in public social spending over the last twenty-five years have been increased support for the (growing) retired population, and health expenditure;

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

13 Australian gross social expenditure is 83 per cent of the OECD-26 average, but direct taxes paid on benefits are 15 per cent of the average and indirect taxes are 47 per cent of the average, and non-superannuation tax breaks are 70 per cent of the average, so that net public spending is 90 per cent of the OECD average. Net mandatory public expenditures are 240 per cent of the average so that net publicly provided or mandated public spending rises to 93 per cent of the average; including voluntary private social spending further raises Australia to 95 per cent of the OECD average.

14 Spending data are also available from 1960 for sixteen countries. On average, social spending roughly doubled in this period.

Table 3.2 From Gross Public to Total Net Social Spending, 2005; Social Expenditure in Percentage of GDP at Market Prices, 2005^a

	Australia	Austria	Belgium	Canada	Czech Republic	Denmark	Finland	France	Germany	Iceland	Ireland	Italy	Japan	Korea	Luxembourg	Mexico	Netherlands	New Zealand	Norway	Poland	Portugal	Slovak Republic	Spain	Sweden	United Kingdom	United States	OECD-26
Gross public social expenditure	17.1	27.2	26.4	16.5	19.5	26.9	24.0	29.2	26.7	16.9	16.7	25.0	17.7	6.9	23.2	7.0	20.9	18.5	21.6	21.0	22.9	16.6	21.2	29.4	21.3	15.9	20.6
Direct taxes and social contributions	0.2	2.4	1.4	0.3	0.0	4.0	2.6	1.4	1.4	0.7	0.2	1.9	0.2	0.0	0.8	0.0	2.3	1.3	1.8	1.5	0.8	0.0	1.2	4.0	0.2	0.5	1.2
Indirect taxes (on cash benefits)	0.8	2.6	2.3	0.7	2.0	2.7	2.6	2.5	1.9	1.1	1.8	1.8	0.6	0.4	3.0	0.1	1.6	1.3	2.1	2.4	2.3	1.8	1.6	2.3	1.4	0.3	1.7
Net TSBPs ^b (not including pensions)	0.4	0.0	0.4	1.1	0.5	0.0	0.0	0.9	1.7	0.0	0.4	0.2	0.7	0.5	0.0	1.4	0.7	0.1	0.1	0.1	0.8	0.1	0.4	0.0	0.4	2.0	0.5
Net current public soc exp	16.5	22.2	23.1	16.6	18.0	20.2	18.8	26.2	25.1	15.1	15.2	21.5	17.6	7.0	19.4	8.2	17.7	16.0	17.9	17.2	20.8	14.9	18.9	23.1	20.1	17.1	18.2
Gross mandatory private soc exp	1.1	0.9	0.0	0.0	0.2	0.2	0.0	0.4	1.1	1.5	0.0	1.5	0.7	0.6	0.2	0.0	0.7	0.0	1.3	0.0	0.4	0.2	0.0	0.4	0.8	0.3	0.5
Direct taxes and social contributions	0.1	0.3	0.0	0.0	0.0	0.1	0.0	0.0	0.4	0.2	0.0	0.2	0.0	0.0	0.0	0.0	0.2	0.0	0.3	0.0	0.0	0.0	0.0	0.1	0.0	0.0	0.0
Indirect taxes	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.1	0.3	0.0	0.2	0.0	0.1	0.0	0.0	0.1	0.0	0.2	0.0	0.1	0.0	0.0	0.1	0.1	0.0	0.0
Net current mand private soc exp	0.8	0.5	0.0	0.0	0.2	0.1	0.0	0.3	0.6	1.0	0.0	1.2	0.7	0.5	0.2	0.0	0.4	0.0	0.7	0.0	0.3	0.2	0.0	0.2	0.7	0.3	0.3
Gross voluntary private soc exp	2.6	1.0	4.5	5.5	0.1	2.4	1.1	2.6	1.9	3.4	1.3	0.6	2.8	1.8	0.9	0.2	7.6	0.4	0.8	0.0	0.4	0.8	0.5	2.4	6.3	9.8	2.4
Direct taxes and social contributions	0.2	0.1	0.3	0.8	0.0	0.8	0.2	0.0	0.2	0.5	0.1	0.0	0.1	0.0	0.0	0.0	1.4	0.0	0.2	0.0	0.0	0.0	0.0	0.5	0.4	0.5	0.0
Indirect taxes	0.2	0.1	0.6	0.4	0.0	0.4	0.2	0.1	0.1	0.6	0.2	0.0	0.2	0.0	0.1	0.0	0.8	0.0	0.1	0.0	0.0	0.1	0.0	0.4	0.6	0.2	0.0
Net current vol private soc exp	2.2	0.8	3.6	4.4	0.1	1.2	0.7	2.5	1.6	2.3	1.1	0.5	2.5	1.8	0.7	0.2	5.5	0.4	0.5	0.0	0.4	0.7	0.5	1.5	5.2	9.1	1.9
Net current private soc exp	3.1	1.4	3.6	4.4	0.3	1.3	0.7	2.8	2.2	3.3	1.1	1.7	3.2	2.4	0.9	0.2	5.9	0.4	1.2	0.0	0.8	0.9	0.5	1.7	5.9	9.4	0.0
Net total social expenditure ^c	19.3	23.5	26.8	20.7	18.2	21.6	19.5	29.0	27.0	18.4	16.1	23.1	20.7	9.4	20.3	8.4	23.3	16.4	19.1	17.2	21.4	15.7	19.1	24.8	25.9	25.3	20.4
Memorandum item																											
TBSPs towards pensions ^d	1.9	0.1	0.2	1.7	0.1	–	0.1	0.0	0.9	1.0	1.4	0.0	0.6	–	0.6	0.1	–	–	0.6	0.2	0.1	0.2	0.3	0.0	1.2	0.8	0.0
Average indirect tax rate	9.8	16.2	15.1	10.7	17.3	25.9	20.8	14.9	13.0	21.6	21.0	12.1	0.6	12.6	22.3	6.3	17.2	15.3	22.5	16.7	16.8	17.0	13.0	20.5	13.3	4.3	15.5

Notes: (a) 2005 social expenditure estimates for Portugal. (b) TBSPs are Tax Breaks for Social Purposes. (c) In order to avoid double counting, the value of TBSPs towards 'current' private social benefits has been ignored for the calculation of net total social expenditure. (d) Because of conceptual issues and gaps in data availability, tax breaks towards old-age pensions are shown in the table as a memorandum item. –: Data not available.

Source: OECD Social Expenditure database (<http://www.oecd.org/document/9/0,3343,en_2649_34637_38141385_1_1_1_100.html>).

and population projections suggest further spending increases in these two areas in future. For the twenty-two countries for which information is available for the whole period from 1980 to 2005, public spending on old age increased from 5.1 per cent of GDP in 1980 to 7.0 per cent in 2005. Similarly, public expenditure on health increased from 4.6 per cent of GDP in 1980 to 6.2 per cent in 2005. The other area where there seems to be some structural spending growth is family benefits. On average across the OECD, spending on family benefits has increased by nearly half a percentage point of GDP since 1990 (there was no significant change in the 1980s). Australia experienced the second-highest proportional increase in spending on families in this period, and the highest increase as a percentage of GDP.

Spending on unemployment compensation fluctuates with the economic cycle. It peaked at 1.9 per cent of GDP in 1993, but at 1.2 per cent of GDP spending was as high in 2003 as it was in the early 1980s, although falling somewhat by 2005. On average across the OECD, spending on incapacity-related support does not appear to be very sensitive to economic patterns. It has been broadly stable at around 2.4 per cent of GDP since 1980. The stability of the OECD average masks widely different country experiences. For example, in the Netherlands, public spending on disability has fallen from 6.5 per cent of GDP in 1980 to 3.6

per cent in 2005; over the same period there have been significant increases in Australia, New Zealand and the United Kingdom, where spending ratios increased from about half the average to the average level in Australia¹⁵ and the United Kingdom and more in New Zealand.

Overall, between 1980 and 2005 gross social welfare spending in Australia increased from 10.6 per cent to 17.1 per cent of GDP, or by 6.5 per cent of GDP (Table 3.3 and Figure 3.3) compared to the average for the OECD of an increase from 16.0 per cent to 20.5 per cent of GDP. The increase in measured spending in Australia was around 50 per cent higher than the OECD average, so that Australia rose from 66 per cent to 83 per cent of the OECD average.

What factors explain this apparently rapid increase in Australia's spending compared to other countries? In a number of areas there were significant real increases, particularly in health care expenditure following the introduction of Medicare in 1984, and also in family payments following a range of reforms from the 1980s onwards, and most recently in 2003.

An important factor is the improvement in data. For the first time from 1990 onwards, OECD data for Australia include estimates of state and territory workers' compensation, with estimated spending on this item being \$5.8 billion in 2005 (and zero because it was not included in 1980). A further factor is the 'GST compensation effect'.

Table 3.3 Trends in Spending on Social Protection, OECD Countries, 1980 to 2005

Year	1980	1985	1990	1995	2000	2001	2002	2003	2004	2005
Australia	10.6	12.5	13.6	16.6	17.8	17.3	17.5	17.8	17.7	17.1
Austria	22.5	23.8	23.9	26.5	26.4	26.6	27.0	27.5	27.3	27.2
Belgium	23.5	26.0	24.9	26.2	25.3	25.8	26.2	26.5	26.6	26.4
Canada	13.7	17.0	18.1	18.9	16.5	17.0	17.1	17.2	16.6	16.5
Czech Republic	–	–	16.0	18.2	19.8	19.8	20.6	20.7	19.7	19.5
Denmark	24.8	23.2	25.1	28.9	25.6	25.9	26.6	27.6	27.5	26.9
Finland	18.0	22.5	24.2	30.9	24.3	24.2	25.0	25.8	26.0	26.1
France	20.8	26.0	25.1	28.6	27.9	27.9	28.6	29.0	29.1	29.2
Germany	22.7	23.2	22.3	26.5	26.2	26.3	27.0	27.3	26.7	26.7
Greece	10.2	16.0	16.5	17.3	19.2	20.6	20.0	19.9	19.9	20.5
Hungary	–	–	–	–	20.0	20.2	21.4	22.2	21.7	22.5
Iceland	–	–	13.7	15.2	15.3	15.3	16.9	18.2	17.9	16.9
Ireland	16.7	21.3	14.9	15.7	13.6	14.4	15.3	15.8	16.2	16.7
Italy	18.0	20.8	19.9	19.9	23.3	23.5	24.0	24.4	24.7	25.0
Japan	10.6	11.4	11.4	14.3	16.5	17.4	17.8	18.1	18.2	18.6
Korea	–	–	2.9	3.3	5.0	5.4	5.3	5.6	6.3	6.9
Luxembourg	20.6	20.2	19.1	20.8	19.7	20.8	22.0	23.4	23.9	23.2
Mexico	–	1.9	3.6	4.7	5.8	5.9	6.3	6.8	6.7	7.0
Netherlands	24.8	25.3	25.6	23.8	19.8	19.7	20.5	21.2	21.1	20.9
New Zealand	17.2	17.9	21.8	18.9	19.4	18.6	18.7	18.2	18	18.5
Norway	16.9	17.8	22.3	23.3	21.3	22.2	23.6	24.5	23.2	21.6
Poland	–	–	14.9	22.6	20.5	21.9	22.3	22.3	21.4	21.0
Portugal	10.2	10.4	12.9	17.0	19.6	19.9	21.3	22.9	23.1	–
Slovak Republic	–	–	–	18.6	17.9	17.6	17.7	17.1	16.5	16.6
Spain	15.5	17.8	19.9	21.4	20.3	20.0	20.4	21.0	21.2	21.2
Sweden	27.1	29.4	30.2	32.1	28.5	28.9	29.5	30.3	29.8	29.4
Switzerland	13.5	14.5	13.4	17.5	17.9	18.4	19.2	20.3	20.3	20.3
Turkey	4.3	4.2	7.6	7.5	–	–	–	–	–	13.7
United Kingdom	16.7	19.8	17.0	20.2	19.2	20.1	20.0	20.5	21.1	21.3
United States	13.1	13.1	13.4	15.3	14.5	15.1	15.9	16.2	16.1	15.9
OECD	16.0	17.7	18.1	19.9	19.3	19.7	20.2	20.7	20.6	20.5

Notes: –: Data not available. OECD averages exclude countries where data are not available for related time series.

Source: OECD (2009), Social Expenditure database (SOCX), <<http://www.oecd.org/els/social/expenditure>>.

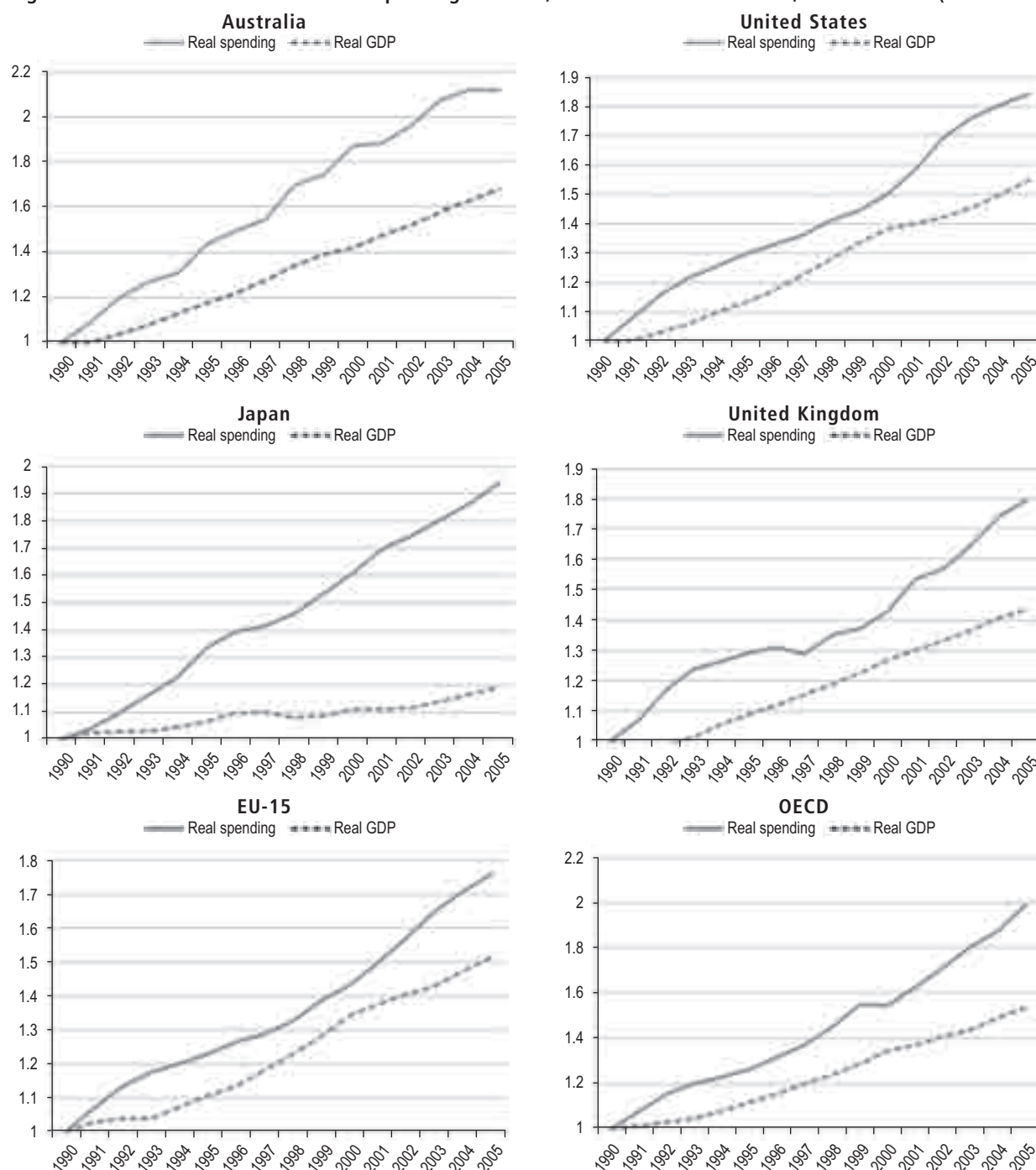
15 These figures do not reflect any impact of post-2005 changes in disability policy.

Australian welfare spending increased by more than \$8 billion between 1999 and 2000, following the introduction of the Goods and Services Tax, somewhat more than the total increase between 1995 and 1999. At 1.1 per cent of GDP this was also the largest change for that year of any OECD country. However, most of this increase was due to the indexation of pensions and benefits to compensate for the price effect of the GST, although there were real increases in family benefits.

These factors—improvements in data from 1990, plus the introduction of the GST in 2000—account for 35 per

cent of the total increase in Australian social spending since 1980. If these effects were excluded then spending on social protection in 2005 would have been about two-thirds of the OECD average, only a little more than in 1980. This implies that it is more accurate to say that since 1980 Australian social spending has increased at roughly the same rate as the average for OECD countries, rather than substantially faster. But it also implies that Australian social spending was previously underestimated, as workers' compensation existed before 1990, but was simply not being counted.

Figure 3.2 Trends in Real Public Gross Spending and GDP, Selected OECD Countries, 1990 to 2005 (1990 = 1.0)



Note: EU-15 countries are: Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Spain, Sweden, and the United Kingdom.

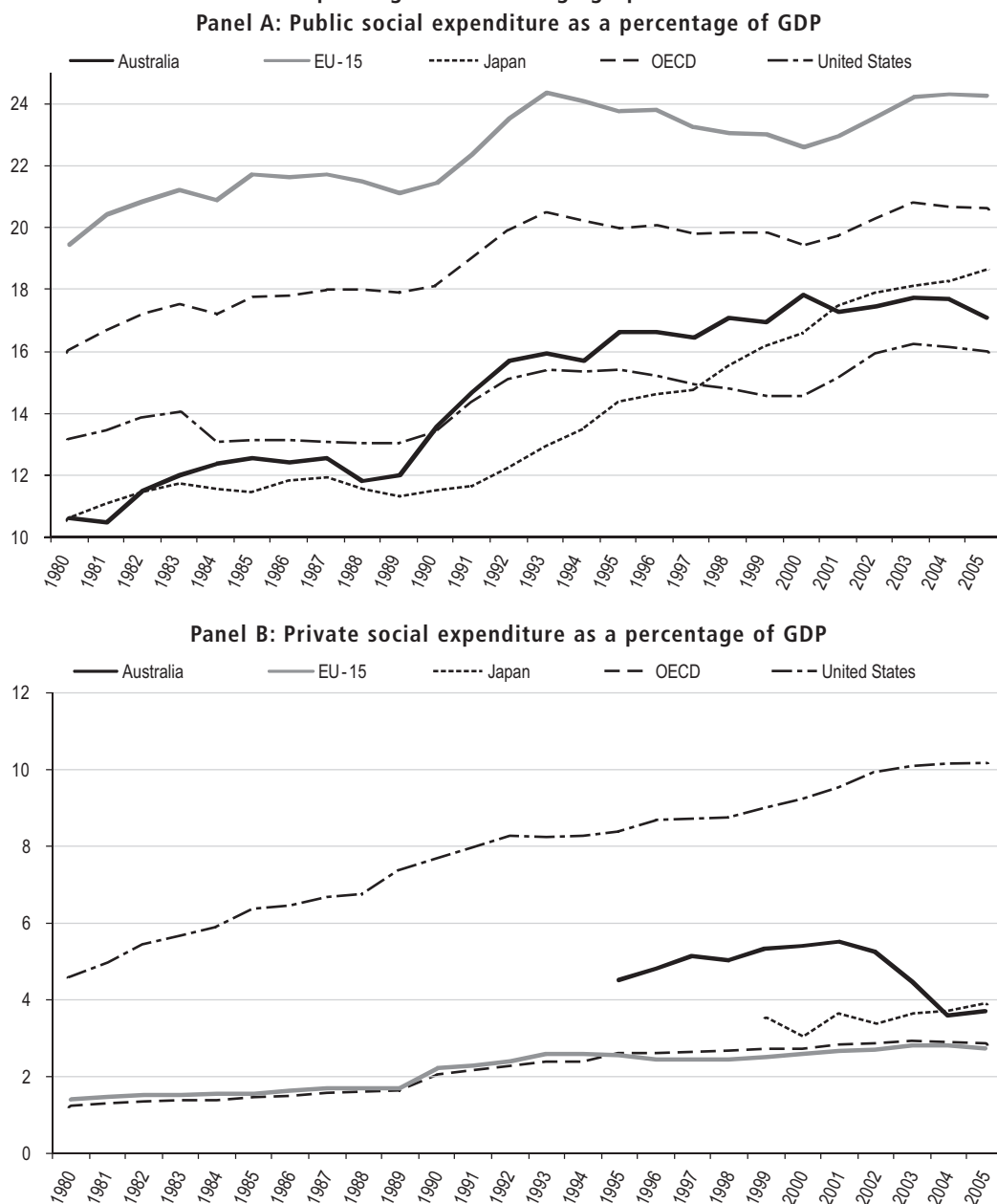
Source: OECD (2008); Social Expenditure database (SOCX), 1980–2005, <<http://www.oecd.org/els/social/expenditure>>.

Unlike public spending trends, private social expenditure-to-GDP trends do not seem to be responsive to the business cycle, but have mainly increased at a steady pace since 1980 (Figure 3.3). The high and increasing level of private spending in the United States is explained by the large role of private and occupational health coverage, in the absence of a public health insurance system with universal coverage. In 2005, voluntary private social health expenditure amounted to nearly 6 per cent of GDP, making the total US health care system the most expensive in the OECD. While data for Australia are only available for the most recent decade¹⁶, they show that private spending is much lower than in the United States but significantly

higher than in many European countries (but not the Netherlands, Switzerland or the United Kingdom).

These trends complicate the notion that private protection is simply replacing public coverage or vice versa. Certainly, reductions in the generosity of public incapacity-related income support and increased employer's responsibility for the provision of sickness benefits in the Netherlands and some Nordic countries contributed to an increase in private spending during the 1990s, but the overall impact was limited. Instead, the ageing of populations, the increased prosperity which allowed increased coverage of private pension saving, and the maturing of private pension programs have contributed to the increase in private spending.

Figure 3.3 Public and Private Social Spending Trends Are Edging Up



Note: EU-15 countries are: Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Spain, Sweden, and the United Kingdom.

Source: OECD (2008); Social Expenditure database (SOCX), 1980–2005, <<http://www.oecd.org/els/social/expenditure>>.

16 The decline in Australian private social spending from 2003 reflects a decline in superannuation payouts (although this subsequently reversed itself).

3.2 Distributional Outcomes and the Architecture of the Australian Tax–Transfer System

3.2.1 Targeting and Progressivity: How Do Social Programs and Taxes Affect Income Distribution?

When considering the redistributive impact of alternative transfer systems it is important to note that their design features differ in significant respects. Two of the most important features relate to the way benefits are *funded*—that is, the different ways in which programs are financed—and *structured*—that is, the relationship between benefits received and the past or current income of beneficiaries. Using these criteria, the social welfare systems of OECD countries are often characterised as either ‘Bismarckian’ or ‘Beveridgean’ (Werding 2003). In the first, social programs are based on social insurance principles, with earnings-related benefits, entitlement based on contribution records and funding through employer and employee social security contributions. In the second, policies are generally characterised by universal provision, with entitlement based on residence and in some cases need, and with benefits that are flat rate and financed through general taxation. As previous discussion has suggested and later discussion will show, Australia can be considered as a ‘hyper-Beveridgean’ welfare system.

A related way of classifying and evaluating alternative welfare state arrangements is on the basis of the forms of redistribution emphasised in different institutional arrangements. Rather than focusing on the early architects of the welfare state this classification looks to the architecture itself. Barr (1992, 1999, 2001) points out that the main objective of transfer systems in most OECD countries is to provide *insurance* in the face of adverse risks (unemployment, disability, sickness) and to *redistribute across the life-cycle*, either to periods when individuals have greater needs (e.g. when there are children in the household) or would otherwise have lower incomes (such as in retirement). Barr (2001) describes this as the ‘piggy-bank objective’.¹⁷

The second main objective of the welfare state can be described as ‘taking from the rich to give to the poor’ (what Barr calls the ‘Robin Hood’ motive). Targeting of benefits is usually justified as a means of achieving the Robin Hood objective. Bismarckian-type welfare states can be characterised as giving priority to the piggy-bank objective, while Beveridgean-type welfare states give priority to the Robin Hood objective. Australia is the strongest

example of a country emphasising the Robin Hood objective both in the design of the system and in much of the public debate about transfer reforms.¹⁸

The differing designs of social programs influence the distribution of household incomes in different ways. In assessing these impacts it is important to distinguish between *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.¹⁹
- » *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? For example, do the poor receive more than the rich from the transfer system?
- » Finally, *redistribution* refers to the outcomes of different tax and benefit systems; how much does the benefit system actually *change* the distribution of household income?

3.2.2 Income Testing and Targeting

An indicator of the extent of targeting is provided in Table 3.4, which shows the level of spending on income-tested cash benefits as a share of GDP and as a share of total cash benefit spending between 1990 and 2005.²⁰ Australia stands out from all other OECD countries, spending more than 6 per cent of GDP on income-tested programs, or close to 80 per cent of its total spending on cash benefits. Canada and New Zealand come next, but spend a little more than half this level on income-tested payments, followed by Finland, Ireland, the United Kingdom, the Czech Republic and Germany. As a share of total cash spending, Canada and New Zealand rank after Australia, and other countries, including Ireland, Korea and Mexico, where income-tested spending is more than 20 per cent of the total. The United States spends somewhat less than the OECD average, and spending on income-tested programs is particularly low—under 5 per cent of total spending—in Hungary, Italy, Japan and Sweden.

Overall, Table 3.4 shows that a low level of spending on income-tested programs tends to be the rule in OECD countries, with the exception of the English-speaking

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

18 It is important to note that programs can aim to achieve both objectives simultaneously. For example, the main objective of family assistance in Australia is to redistribute across the life course, but at the same time Australia also provides much higher levels of assistance to low income families than to higher income families.

19 Other forms of targeting are possible, such as benefits directed to particular geographic areas; these are more common in low-income countries.

20 These programs have been identified through analysis of the OECD Social Expenditure database and, in addition to social assistance payments, they include income-tested spending on the unemployed, separate income-tested payments for older people and people with disabilities, and income-tested family cash benefits, but do not include housing benefits.

Table 3.4 Extent of Income Testing in Cash Benefit Programs, OECD Countries, 1990 to 2005

	% of GDP				% of public cash benefits			
	1990	1995	2000	2005	1990	1995	2000	2005
Australia	6.5	7.4	7.5	6.3	89.1	81.1	80.9	77.8
Austria	1.0	1.2	0.9	1.1	5.6	6.1	5.1	5.8
Belgium	0.9	1.2	0.8	0.9	5.4	6.7	5.4	5.7
Canada	3.2	3.8	3.6	3.3	35.6	45.4	51.3	48.8
Czech Republic	2.9	2.1	1.9	1.6	27.0	19.0	15.9	14.1
Denmark	–	1.4	1.0	1.0	–	8.3	7.9	7.3
Finland	–	3.4	3.0	2.6	–	17.0	20.1	17.2
France	1.6	1.8	1.8	1.9	10.1	10.3	10.5	10.6
Germany	0.9	1.2	1.3	1.5	6.7	7.9	8.3	9.7
Greece	0.2	0.2	1.1	1.3	2.0	2.0	8.7	9.8
Hungary	–	–	0.7	0.6	–	–	5.9	4.2
Iceland	1.8	1.6	1.0	1.0	32.6	26.0	19.0	18.2
Ireland	3.3	3.8	2.4	2.6	37.9	44.1	34.3	30.6
Italy	0.7	0.7	0.6	0.7	5.1	4.7	3.7	4.0
Japan	0.2	0.3	0.3	0.5	4.0	3.8	3.7	4.8
Korea	0.2	0.1	0.3	0.7	15.0	7.0	13.9	25.3
Luxembourg	–	–	–	0.5	–	–	–	3.3
Mexico	0.3	0.7	0.5	0.5	50.9	51.4	35.0	25.9
Netherlands	–	1.7	1.1	1.1	–	11.4	10.1	9.8
New Zealand	3.7	3.3	3.6	3.4	27.7	31.1	34.9	37.2
Norway	1.5	1.4	1.1	1.1	11.7	10.9	9.8	9.8
Poland	–	–	0.8	1.1	–	–	5.0	7.0
Portugal	0.4	0.5	0.7	–	5.4	4.3	5.4	–
Slovak Republic	–	2.7	2.4	0.6	–	23.3	20.2	5.5
Spain	2.0	2.2	1.8	1.6	15.0	14.9	13.6	12.3
Sweden	–	1.4	1.0	0.6	–	8.7	7.1	4.3
Switzerland	0.6	1.0	1.0	1.1	7.2	8.6	9.6	8.9
Turkey	0.0	0.0	–	–	0.0	0.2	–	–
United Kingdom	2.0	2.8	1.9	1.7	21.6	26.0	19.4	16.5
United States	1.3	1.6	1.2	1.2	16.3	19.5	15.6	15.6
OECD	1.4	1.6	1.5	1.6	17.9	17.1	16.8	17.3

Notes: The following income-tested spending items are included: spending on 'other contingencies—other social policy areas' as in the OECD Social Expenditure database (SOCX), income-tested spending on the unemployed (e.g. unemployment assistance payments for Germany), income-tested support payments to the elderly and disabled (e.g. Belgium and the United Kingdom), other income tested payments (family cash transfers) but do not include specific housing subsidies, spending on active labour market policies, or income-tested medical support. –: Data not available.

Sources: OECD Secretariat calculations based on OECD (2009); Social Expenditure database (SOCX), <<http://www.oecd.org/els/social/expenditure>>.

countries—but not including the United States—and with Finland apparently being closer to the English-speaking countries than other Nordic welfare states. There also does not appear to be any consistent trend between 1990 and 2005 in spending on income-tested benefits. In a number of countries, such as Belgium, Canada, Denmark, Finland, Iceland, Spain and the United Kingdom, this spending peaked around 1993, probably reflecting the impact of the recession in the first part of the 1990s, which was likely to be associated with increased spending on income-tested unemployment payments. A few countries have seen relatively large increases but from low bases (Germany, Greece, Korea and Portugal), while a number have seen declines (Denmark, Norway, Spain and Sweden).²¹

The extent of income testing, however, is not a comprehensive indicator of the redistributive profile of different social security systems, as it is possible to redistribute between rich and poor through means other than direct income testing. For example, all OECD countries have safety nets to prevent old-age poverty, but there are four generic types: social assistance; separate, targeted

retirement income programs; basic pensions; and minimum pensions within earnings-related plans. All are mandatory and publicly provided (Whiteford & Whitehouse 2006).

The benefits of basic schemes are a flat rate, with the same amount paid to each retiree, depending only on the number of years of work (but not on earnings). Entitlement does not vary with the level of other pension income. Ten OECD countries have a basic pension scheme that plays an important role in providing retirement incomes. Targeted plans, in contrast, pay a higher benefit to poorer pensioners and reduced or zero benefits to better-off retirees. There are three ways of targeting. First, benefits can be pension-income tested (where the value depends only on the level of pension income a retiree receives).²² Second, benefits can be more broadly income tested (reducing payments if, for example, a retiree has income from savings) or third, means tested (reducing the pension to take account of both income and assets). Australia's age pension is an example of this sort of means-tested scheme. Overall, there are thirteen OECD countries where targeted retirement-income programs are significant.

21 It is important to note that while Table 3.4 shows a decline in Australia in the share of total spending that is on income-tested programs, not all programs are covered in this table in order to achieve consistency across countries.

22 Sweden's guarantee pension is an example.

Table 3.5 Progressivity Measures for Transfers by Household Group, 1990s to 2005

	Ratio of transfers paid to poorest quintile to those paid to richest quintile						Middle class welfare: share of transfers received by richest half of the population						Ratio of transfers to taxes for lowest quintile		
	Working age			Retirement age			Total								
	1995	2000	2005	1995	2000	2005	1995	2000	2005	1995	2000	2005	1995	2000	2005
Australia	6.8	12.7	15.1	1.2	1.4	1.7	6.4	10.4	12.4	22.9	18.6	18.6	36.0	55.5	31.7
Austria	0.9	1.1	0.5	1.1	0.4	0.3	1.0	0.7	0.4	49.2	—	60.0	—	—	2.8
Belgium	1.1	1.1	1.9	0.3	0.3	0.4	1.0	1.0	1.7	46.6	37.9	39.3	—	—	4.9
Canada	1.5	1.7	2.5	0.9	1.0	1.0	1.5	1.7	2.3	42.9	43.2	38.0	4.5	3.7	5.9
Czech Republic	3.2	2.7	2.2	0.8	0.9	0.9	3.2	2.8	2.1	31.2	32.5	35.5	9.6	9.9	7.4
Denmark	3.4	4.8	4.9	1.2	1.3	1.4	3.7	4.9	5.1	28.8	25.7	24.3	2.8	2.9	2.9
Finland	3.1	4.0	3.6	1.0	1.7	1.9	2.7	3.3	3.1	36.1	35.2	34.2	3.9	3.9	3.9
France	—	—	0.6	—	—	0.2	—	—	0.5	—	—	58.5	—	—	3.6
Germany	1.9	1.4	1.4	0.3	0.4	0.4	1.1	1.0	0.9	47.0	47.0	49.6	3.5	4.7	6.7
Greece	0.5	0.3	0.4	0.2	0.3	0.3	0.5	0.4	0.5	59.1	58.4	57.6	—	—	—
Hungary	1.0	1.3	1.0	0.6	0.6	0.5	1.0	1.2	0.9	48.2	44.3	48.0	—	—	—
Iceland	—	—	0.8	—	—	0.8	—	—	1.1	—	—	44.6	—	—	0.9
Ireland	3.6	3.4	2.7	0.8	0.8	1.0	3.2	3.1	2.7	30.2	29.6	32.5	29.4	24.2	32.9
Italy	0.4	0.4	0.4	0.3	0.3	0.3	0.4	0.5	0.5	61.5	56.4	58.5	3.9	5.3	6.6
Japan	0.9	0.8	0.8	0.6	0.5	0.5	0.9	0.8	0.9	50.3	41.7	49.1	2.0	2.0	2.7
Korea	—	—	0.9	—	—	0.2	—	—	1.0	—	—	46.7	—	—	1.8
Luxembourg	1.1	1.1	0.7	0.6	0.5	0.5	0.9	1.0	0.6	51.0	39.1	54.5	—	—	3.1
Mexico	0.2	0.1	0.2	0.1	0.0	0.0	0.2	0.1	0.2	73.1	70.4	73.9	—	—	—
Netherlands	3.1	3.2	3.0	1.0	1.0	1.0	2.6	2.7	2.6	35.8	34.0	34.7	3.4	4.9	6.5
New Zealand	7.9	6.9	7.6	1.0	1.0	1.0	6.4	5.0	8.1	25.3	27.7	21.5	21.9	19.1	8.3
Norway	2.8	2.6	2.7	0.7	0.7	0.7	2.8	2.9	2.6	32.7	32.1	35.3	5.6	4.4	3.9
Poland	—	0.7	0.4	—	0.4	0.4	—	0.6	0.3	—	48.9	63.6	—	—	1.9
Portugal	0.4	0.4	0.2	0.3	0.2	0.2	0.5	0.5	0.3	57.3	45.5	64.7	9.1	5.4	4.5
Slovak Republic	—	—	1.0	—	—	0.6	—	—	1.1	—	—	46.2	—	—	4.8
Spain	0.7	0.6	0.6	0.5	0.5	0.4	0.6	0.7	0.7	54.7	53.1	53.9	—	—	—
Sweden	1.9	2.2	2.3	0.5	0.5	0.6	1.6	2.0	2.0	41.9	37.5	37.9	3.3	3.3	3.0
Switzerland	—	2.1	2.5	—	0.9	0.9	—	2.3	2.5	—	38.9	38.0	—	1.0	1.0
Turkey	0.3	—	0.1	0.1	—	0.1	0.2	0.0	0.1	67.2	—	75.0	—	—	—
United Kingdom	6.2	7.2	6.2	0.9	0.9	0.9	4.1	5.3	4.5	27.7	24.7	26.8	12.3	15.7	11.1
United States	1.9	1.8	1.7	0.6	0.5	0.5	1.6	1.4	1.5	41.2	26.7	42.2	8.0	5.3	5.8
OECD	2.3	2.6	2.3	0.7	0.7	0.7	2.0	2.2	2.1	44.2	39.5	45.4	10.0	10.1	6.7
Australia/mean	3.0	4.9	6.6	1.8	2.1	2.7	3.2	4.8	5.9	0.52	0.47	0.41	3.6	5.5	4.7

Note: —: Data not available.

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

Minimum pensions—such as pension-income tested, targeted plans—aim to prevent pensions from falling below a minimum level. But the institutional set-up and eligibility conditions are different. Usually, retirees must have paid contributions for a minimum number of years in order to receive this benefit. Minimum credits in earnings-related schemes, such as those in Belgium and the United Kingdom, also belong to the first tier: benefit calculations for workers with low earnings assume the worker's earnings were higher. Finally, Germany and Italy do not have specific, targeted programs for older people, but general social assistance benefits protect poor older people. Most countries rely on one primary instrument to prevent old-age poverty, but there are cases where a combination of several schemes applies.

Table 3.5 provides a range of measures of the overall progressivity of transfers in OECD countries between the mid-1990s and 2005. The first measure shown is the 'ratio of transfers'; the share of transfers received by the poorest population quintile compared to the share received by the richest quintile²³, with results disaggregated by age of household head. It is readily apparent that overall, and for people of working age, Australia has the most progressive benefit structures in the OECD—and by an extremely wide margin. In 2005, the average OECD value for the total population was 2.1, but the Australian ratio was 12.4, with the next most targeted being New Zealand, where the ratio was roughly two-thirds of Australia's level. In general, the most targeted systems are the English-speaking countries of Australia, New Zealand, Ireland and the United Kingdom (but not Canada and the United States, where the ratio is only average or below), together with the Czech Republic, and Denmark, Finland and Norway (but not Sweden), and the Netherlands.²⁴

Transfers to people of working age are even more targeted with the Australian ratio at 15.2 being roughly twice as progressive as the next ranked country, New Zealand. There also appears to have been a significant increase in targeting of payments in Australia over the decade shown. Payments to households with a retirement-age head are generally less targeted because they go to a majority of the relevant population group rather than a minority as is the case with payments to people of working age. The Australian pension system is the second-most progressive in the OECD after Finland.

This 'ratio of transfers' measure, however, suffers from the limitation that it is strongly influenced by how much goes to the richest 20 per cent of the population and ignores how much goes to the middle of the income distribution. What is unusual about Australia is the smallness of the share going to the richest 20 per cent of

the population, this being only 3 per cent of all transfer spending. The only other countries where the wealthiest receive a comparatively small amount from the transfer system are New Zealand (4 per cent), Denmark and the United Kingdom (where they receive between 6 per cent and 10 per cent of all transfer spending), and Canada, the Czech Republic, Finland, Ireland, the Netherlands and Norway where they receive a little over 10 per cent.

Defining 'middle class welfare' is difficult because there is no consensus on who exactly is middle class.²⁵ The fourth panel of Table 3.5 shows the share of transfers going to the richest 50 per cent of households. On average the richest half of the population in OECD countries receives 45 per cent of all cash transfers, and on this measure Australia has by far the lowest level of middle class welfare at 19 per cent of transfers paid; other countries with limited middle class welfare include New Zealand, Denmark and the United Kingdom. Middle class welfare is most extensive in Austria, France, southern European countries and Poland, and particularly in Mexico and Turkey where the richest half of the population receives nearly three-quarters of all transfers.

The final panel of Table 3.5 shows the ratio of the transfers received by the poorest quintile of the population to the taxes they pay—a measure of how much the poor pay for their own benefits. Australia and Ireland stand out. In 2005, in both countries the poorest quintile received more than thirty times as much in cash transfers as they paid in direct taxes, followed at a considerable distance by New Zealand, the United Kingdom and the Czech Republic. This ratio apparently rose significantly in Australia between 1995 and 2000 and then fell back to its earlier level by 2005; however, this large swing reflects the fact that the taxes paid by the poorest 20 per cent of Australian households are extremely low so that small changes in this denominator can change the ratio of transfers to taxes significantly.

In summary, these results show that Australia plays 'Robin Hood' and targets assistance to the poor in two ways. First, through income and means testing so that payments to better-off households are minimised and, second, through extremely low levels of direct taxes on poor households, so that very little of the assistance directed to lower income groups is clawed back. The combination of these two features has a strong effect on how much redistribution to the poor is achieved.

3.2.3 Redistribution across the Life Course—the 'Piggy Bank Objective'

The degree of targeting that characterises the Australian transfer system is highly unusual. In practice, transfer systems in all OECD countries—also including Australia—involve a mix of redistribution between rich and poor and

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

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

25 One approach is to consider the best-off 10 per cent or 20 per cent to be rich, but inspection of the incomes of those in these broad groupings suggests that most of these groups are upper-middle income at best, with the truly rich being a minority in the top income decile.

risk insurance or life-cycle redistribution, although the mix of elements differs between countries.

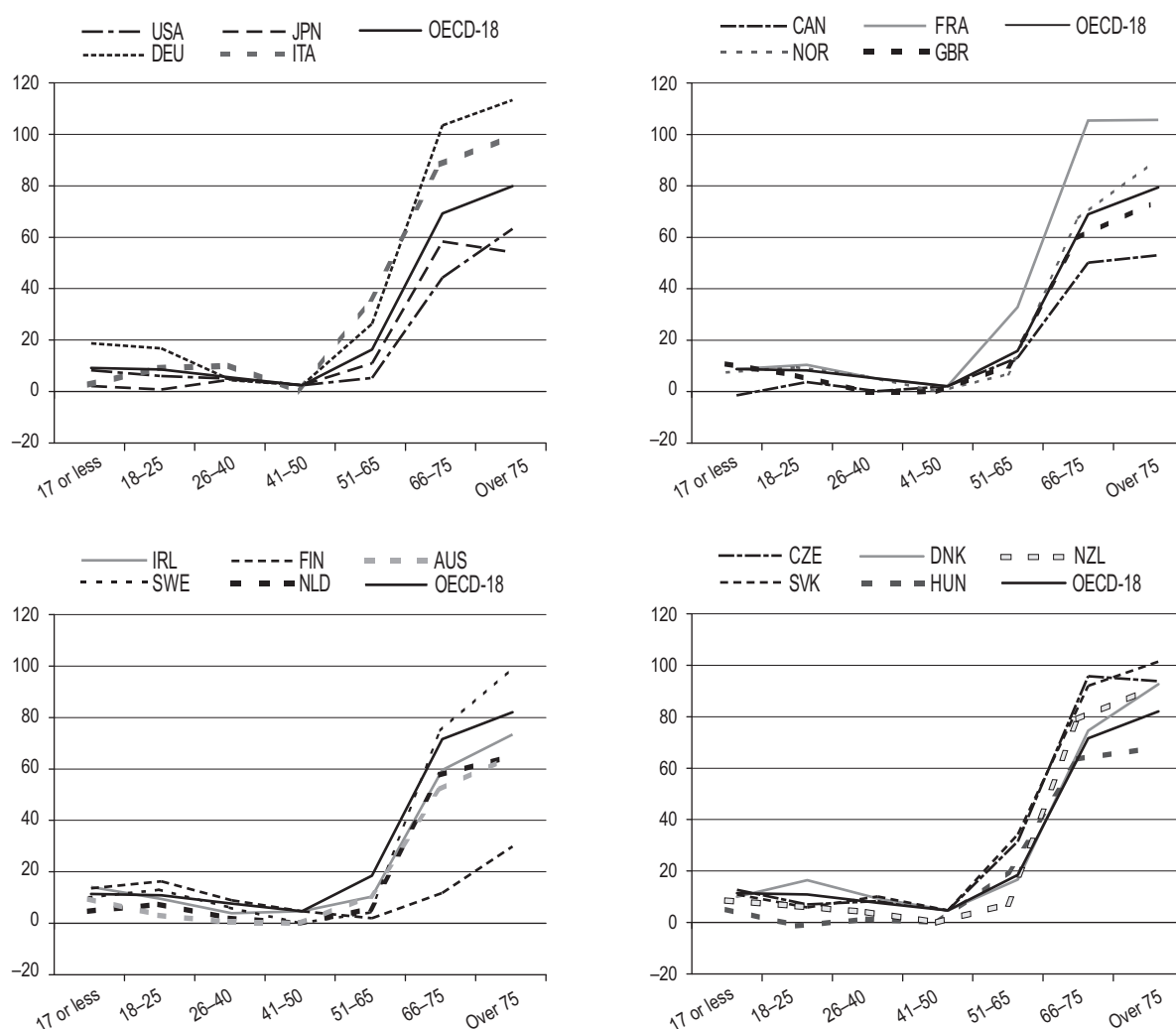
An indication of the importance of life-cycle redistribution is the extent to which social protection systems emphasise support for older people. Spending data show that social protection systems in most OECD countries have as their primary focus the well-being of pensioners or those over retirement age. It can be estimated that on average roughly two-thirds of social spending in OECD countries is directed towards pensioner households; as much as 80 per cent in Italy and Greece and close to 90 per cent in Turkey. At roughly 55 per cent, Australia is towards the lower end of the OECD range, but spending on pensioners through cash benefits, health care and other services remains a major part of social spending.

Similarly, Figure 3.4 shows the share of net benefits (public cash benefits less household taxes) for different age groups, relative to that of people aged 41–50. Net benefit rates are typically positive for individuals at retirement age

and negative for younger groups. When compared to those of the reference group aged 41–50 (the group that pays the highest amount of taxes relative to the benefits that they receive) children below 18 are only slightly better off. There are, however, large differences across countries in these profiles, which rise much more steeply in Germany, Italy and Sweden than in Australia, Canada and the United States. These age-income profiles are important not just for their influence on the current distribution of household income but also because they give an indication of how demographic changes may translate into higher public spending in the future (Dang et al. 2006).

Even these measures, however, are based on point-in-time data, and the precise nature of the mix between redistribution to the poor and redistribution across the life-cycle cannot be observed directly in annual data on incomes or social spending, since annual data cannot identify the extent to which households have already paid for their benefits in past years, or the extent to which they will do so

Figure 3.4 Share of Net Public Benefits in Disposable Income of each Age Group, Mid-2000s; Percentage Point Differences Relative to that of People Aged 41–50



Note: OECD-18 include Australia, Canada, Czech Republic, Denmark, Finland, France, Germany, Hungary, Ireland, Italy, Japan, the Netherlands, New Zealand, Norway, Slovak Republic, Sweden, the United Kingdom and the United States.

Source: OECD (2008).

in the future or the extent to which current taxpayers will be future beneficiaries.

As a result, various ways of modelling the lifetime distribution of benefits and taxes are required. In the United States, for example, many studies of social security evaluate the extent to which the system provides 'value for money', that is, the extent to which individuals with different characteristics receive in retirement more or less than they contributed during their working lives (Leimer 1995; Geanakoplos, Mitchell & Zeldes 2000).

In a comparative study, Falkingham and Harding (1996) compared Australia and the United Kingdom and estimated that in Australia 38 per cent of lifetime benefits received by individuals, on average, were financed through taxes they paid at another stage in their life-cycle, and the remaining 62 per cent of lifetime benefits involved redistribution between rich and poor; in the United Kingdom these shares were reversed, with 38 per cent of lifetime benefits involving redistribution between individuals and 62 per cent involving redistribution over different phases of the life-cycle of the same individual.

A survey by Ståhlberg (2007) compares a wider range of countries and shows that the degree of redistribution across the life-cycle is negatively correlated with the level of targeting, that is, systems that target low-income households at a point in time are more redistributive between rich and poor, but achieve less life-cycle redistribution.²⁶ Ståhlberg (2007) distinguishes between the 'yearly give and take' and the 'life-cycle give and take' and cites a study for Sweden that finds that just over eight out of every ten Swedish kronor which the average individual receives in transfers and subsidies over the life course have been financed by the individual himself. Only 18 per cent of the redistribution which takes place via taxes, transfers and public consumption is genuine redistribution between individuals. Another study cited by Ståhlberg finds that in Italy the corresponding

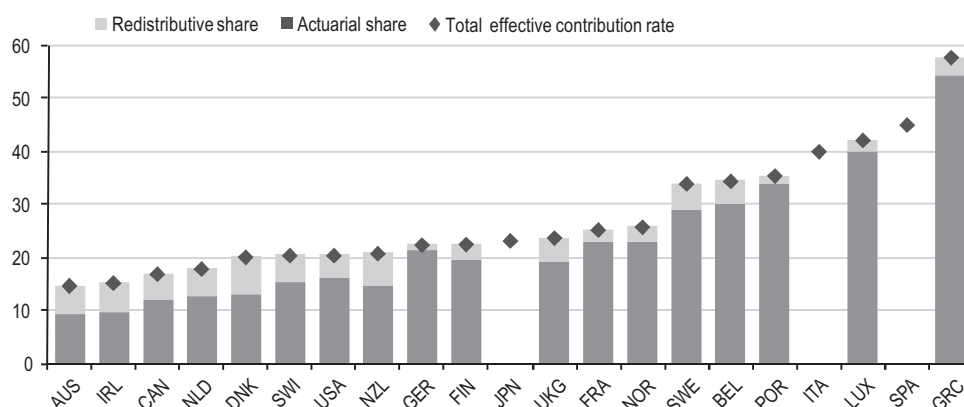
figure is around 24 per cent. Overall, she concludes that countries such as Australia, the United Kingdom and Ireland achieve a higher component of redistribution between rich and poor, but a lack of truly comparable studies makes it difficult to conclude whether the overall level of inter-personal redistribution is higher in more targeted welfare states (since spending is lower).

The actual distribution of benefits across the life-cycle for individuals, however, is likely to differ from calculations of this sort, since both money's worth calculations and micro-simulations usually look at hypothetical lifetimes and calculate the extent of lifetime redistribution on the basis of the tax and benefit system at a specific point in time. In practice, taxation and benefit systems can be changed many times during an individual's lifetime. Some studies, therefore, attempt to estimate to what extent different generations are net beneficiaries or net contributors to social security systems (Thomson 1989; Williamson, Watts-Roy & Kingston 1999).

A further complication relates to the unit assumed to pay taxes and receive transfers in these models. Falkingham and Harding (1996) find, for example, that the family in Australia redistributes as much lifetime income as does the tax system. An individualistic approach to estimating the extent of redistribution across the life course also does not deal with the issue of whether working age individuals benefit from transfers to other households to whom they are related. For example, in the absence of government transfers individuals may have to make private monetary or in-kind transfers to support retired, ill or unemployed relatives.

Another measure of the balance between these two types of redistribution is shown in Figure 3.5, derived from Disney (2004). This shows the effective contribution rates to public pensions as a percentage of earnings (with countries ranked by the level of contributions required) as well as the part that redistributes between individuals, on one side, and

Figure 3.5 Contribution Rates to Public Pensions, Redistributive and Actuarial Components, 1995



Notes: The effective contribution rate is the average rate of contributions as a per cent of earnings required to finance current spending on public pensions without budgetary transfers or accumulation or decumulation of pension funds. The redistributive share of contributions is calculated as the coefficient of variation of replacement rates at different points in the earnings distribution, with the actuarial share being the extent to which entitlements are proportional to lifetime earnings.

Source: Disney (2004).

26 Ståhlberg (2007) notes that about thirty dynamic micro-simulation models have been constructed internationally, with approximately ten models in active use at present. Studies which have used dynamic micro-simulation models to investigate lifetime income and intra-personal redistribution include countries such as Australia, Ireland, Italy, the Netherlands, Sweden, the United Kingdom and the United States.

across the individual's lifetime, on the other.²⁷ In an actuarially fair system, individual pension entitlements would exactly match individual earnings. In contrast, in a redistributive system there is little or no relationship between lifetime earnings and individual entitlements, and rates of return on contributions differ significantly between generations.

A number of points should be emphasised. First, on this measure the share of redistribution between rich and poor varies widely across countries. Second, in all countries—including Australia—the larger part of pension contributions goes towards redistribution across the life-cycle. However, there is greater cross-country variability in the level of contributions going towards life-cycle redistribution than towards redistribution between rich and poor. Lastly, there tends to be an inverse relationship between the degree of redistribution between rich and poor and the level of contributions; countries that spend the most tend to concentrate more on redistribution across the life-cycle, while those that focus more on redistribution between rich and poor spend less. Thus while Australia has the lowest effective total contribution rate of any of these countries, in absolute terms it has the third-highest redistribution tax rate (with implications for the generosity of payments and for incentives).

Redistribution across the life-cycle cannot reduce lifetime inequality between individuals, since it is simply a way of smoothing consumption for the same person, whose total lifetime income remains unchanged; it can, however, reduce inequality at a point in time, and lower both lifetime poverty (for those whose average lifetime incomes are above the poverty line) and poverty at a point in time (Åberg 1989).²⁸

Moreover, life-cycle redistribution can also occur—and in some countries may be most common—through instruments that fall outside the traditional boundaries of the welfare state. For example, home ownership is strongly redistributive across the life-cycle, as families usually face higher expenses for home purchase while they are working and then benefit from lower housing costs when in retirement. Similarly, private health insurance, personal savings, individual pension plans and endowment insurance involve either self-insurance or redistribution across an individual's or family's own life-cycle, while usually providing no redistribution between income groups. A crucial difference between private and government redistribution across the life-cycle is that private redistribution does not normally involve the pooling of risks (except in the case of insurance policies).

3.2.4 Churning

Despite the highly targeted nature of Australia's benefit system, it is sometimes argued that the system is not targeted enough. Two related concerns are that there is unnecessary 'churning' of benefits and taxes and that Australia has too much 'middle class welfare', as discussed above.

Table 3.6 Churning of Transfers and Taxes, OECD Countries, 2000 and 2005

	2000		2005	
	Disposable income	Direct taxes	Disposable income	Direct taxes
Australia	5.6	22.7	5.5	23.3
Austria	–	–	27.5	80.5
Belgium	18.0	48.1	19.8	51.9
Canada	13.0	44.4	9.2	35.6
Czech Republic	10.3	52.7	11.8	54.8
Denmark	18.0	70.7	23.7	49.2
Finland	11.1	34.0	10.3	34.2
France	9.2	100.0	24.6	94.9
Germany	20.4	53.3	20.0	56.3
Iceland	–	–	19.2	36.1
Ireland	7.5	43.8	7.7	39.5
Italy	21.1	73.0	20.0	66.0
Japan	9.9	51.0	13.8	70.0
Korea	–	–	3.0	36.4
Luxembourg	–	–	19.4	81.4
Netherlands	13.4	39.0	10.2	41.4
New Zealand	7.5	27.1	6.8	23.5
Norway	14.2	41.5	15.3	45.9
Poland	–	–	24.7	89.1
Portugal	13.5	78.0	19.9	68.6
Slovak Republic	–	–	14.7	73.6
Sweden	23.6	51.0	24.0	55.6
Switzerland	20.2	59.5	15.6	43.3
United Kingdom	12.0	56.0	7.1	29.3
United States	12.7	39.7	6.4	25.1
Average	13.7	51.9	14.6	52.2

Notes: (a) Churning is calculated by comparing the level of transfers received by each decile with the level of direct taxes (income taxes and employee social security contributions) paid by each decile. Where transfers exceed taxes, then churning is the level of taxes, and where taxes exceed transfers, churning is the level of transfers. The results are then expressed as a percentage of household disposable income and also as a percentage of direct taxes. (b) The ratio of transfers to taxes is the sum of all transfers to households as a percentage of direct taxes paid by households. –: Taxation data not available.

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

Concern with churning is related to the possibility that households can be both recipients of welfare and taxpayers simultaneously, or that individuals pay taxes at some stages of their life course that they recoup in benefits at other times (Saunders 2005a, 2005b). Ståhlberg (2007) calls this the 'yearly give and take' and the 'life-cycle give and take' respectively. It is argued that this flow of transfers into households and taxes out of the same households may involve unnecessary administrative duplication, impose compliance costs on households, and reduce choice. Saunders (2005a) has argued that the efficiency of welfare arrangements could be significantly enhanced without compromising poverty alleviation by reducing the 'churning' of taxes and benefits, both at a point in time and over the life-cycle.

27 The effective contribution rate is the average rate of contributions required to finance current spending on public pensions without budgetary transfers or accumulation or decumulation of pension funds.

28 While total lifetime income for an individual is unchanged by redistribution across the life-cycle, income smoothing can reduce the share of time that might otherwise be spent below the poverty line by those whose average incomes are above the poverty line. However, while people whose lifetime incomes are below the poverty line can theoretically have their incomes raised above the poverty line at different points in time, this could only be achieved at the cost of more severe poverty (i.e. a larger poverty gap) in other periods.

OECD (1998) provided early estimates of the level of simultaneous churning of direct taxes and transfers, covering ten OECD countries in the mid-1990s. This analysis showed that Australia had lower churning than any of the other countries in this study, including Japan and the United States, which have lower levels of social security expenditure than Australia.²⁹ This is likely to be the result of the very low share of transfers going to the rich in Australia, and the very low share of direct taxes paid by the poorest quintile.

Table 3.6 provides updated (and corrected) estimates of simultaneous churning for 2000 and 2005. Churning is calculated as the difference between direct taxes paid and cash transfers received by decile groups. First, each income decile is identified as either net transfer recipients or net taxpayers. Then, for net transfer recipients, the direct taxes paid are calculated as a percentage of disposable income; where deciles are net taxpayers, transfers are calculated as a percentage of disposable income. The level of churning is the average of these amounts across all decile groups, weighted by the decile shares of disposable income.

The implication of this is that where deciles are net transfer recipients it would theoretically be possible to reduce direct taxes paid and then reduce transfers correspondingly, without making them financially worse off. At the other end of the income scale, it would be possible to reduce transfers received by net taxpayers, and then equally offset their direct taxes, also without making them worse off. In theory, both taxes and transfers could be scaled back by the amount of churning without any change to the net redistributive impact of the two systems, and the same net redistribution could be achieved with a lower level of both transfers and taxes, making the system more 'efficient'.

Table 3.6 shows that Australia had the lowest level of churning of any country in 2000, at around 5.6 per cent of disposable income, and in 2005 the level of churning was almost exactly the same, though the data from Korea (available for the first time), showed that Korea now had the lowest level of churning—mainly reflecting the fact that the level of transfers in Korea was about half that of Australia's. Other countries with low levels of churning in both years were New Zealand, Ireland, Canada, Japan and, apparently, France in 2000 but not in 2005, while the countries with the highest level of churning were Germany, Italy, Sweden and Switzerland in both years and Denmark and Poland in 2005.

It should be noted that the volume of churning would differ markedly if expressed as a percentage either of direct taxes paid in each country (also shown in Table 3.6) or of transfers received.³⁰ This is because the countries with the highest level of churning also tend to have the highest level of spending and taxing. Table 3.6 shows that churning in Australia was equivalent to around 23 per cent of direct taxes in both 2000 and 2005—a considerably lower percentage

than the figure for Korea; while this is the lowest level of any of these countries, there is some convergence. For example, using this alternative base, the estimate of churning doubles for Sweden, but rises four-fold for Australia.

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

Is churning a useful concept in assessing the efficiency or effectiveness of tax-transfer systems? In fact, there are reasons for thinking that the concept or at least the way it is measured may be misleading in important respects. For example, Table 3.6 shows that in 2000 churning as a percentage of disposable income was relatively low in France, but as a percentage of direct taxes it was higher than any other country. Indeed, these figures imply that France could have completely abolished its income tax and employee social security contributions had it been able to reduce churning to zero (and it was thought this was a sensible policy). The explanation for this unusual result is that France relies heavily on indirect taxes—particularly employer social security contributions and VAT—rather than direct taxes, and indirect taxes are not measured in household surveys. As a result, on average, households in France, Austria, the Czech and Slovak Republics, Luxembourg and Poland receive more in benefits than they pay in direct taxes, while at the other extreme, households in the United States pay nearly three times as much in direct taxes as they receive in transfers. A more complete accounting of the taxes that finance welfare state provisions suggests that in these countries churning would actually be higher than the levels shown here. These results suggest that estimates of churning restricted to direct taxes and cash benefits should be treated with caution.

A further measurement issue is that these estimates are calculated by comparing average benefits received and taxes paid by decile groups; but it is theoretically possible that half the households in a decile pay all the taxes and the other half receives all the benefits, without any overlap between them. While this is not particularly likely, it means that the level of churning estimated above is probably an

29 The 1998 OECD estimates contain a measurement error because churning was calculated as the simple average of the level of 'unnecessary' taxes or transfers, but it is necessary to weight the average to reflect differences in the proportion of private income in different income deciles. When this is done, the calculated level of churning for Australia fell from 6.5 per cent of income before taxes and transfers to 4.25 per cent.

30 The choice of the appropriate denominator—disposable income or taxes or transfers themselves—depends on one's view of why churning is a problem. If churning is seen as a problem of broader economic efficiency, then disposable income could be regarded as the appropriate basis for comparison. If it is seen as a problem of tax inefficiency then taxes are likely to be the appropriate denominator.

upper limit. Comparisons across household types rather than deciles have similar problems.

A further issue is that estimates of churning are based on analysis of household incomes, but the income tests in the Australian transfer system are generally based on 'income units', the nuclear family. A greater prevalence of families sharing households will increase the level of churning. For example, a retiree living with adult children or an unemployed youth living at home count as transfer recipients in households of net taxpayers. From a purely measurement perspective, it would be possible to reduce churning if these beneficiaries moved to separate households. Policies to encourage this would probably neither be economically efficient nor socially desirable. In this context, some cross-country differences in churning levels are due to differences in household living arrangements rather than in the efficiency of social security systems. For example, a relatively high proportion of Japanese retirees live with adult children, and high proportions of households in Southern Europe contain youth still living at home.³¹

The term 'churning' itself is an example of persuasive labelling; it gives the impression that what is happening is haphazard or unplanned, or is the result of badly designed or irrational policies. But churning may result from intentional policy changes designed to reduce poverty or promote economic efficiency. For example, the July 2000 reforms to the Australian taxation system involved the introduction of the goods and services tax and a compensation package of increased benefits and family payments. Since one of the major components of churning, more broadly defined, relates to the indirect taxes paid by the lowest 60 per cent of households, these reforms undoubtedly increased churning. However, the objective of the reform was to increase economic efficiency while protecting low-income groups from the adverse effects of higher prices. Correspondingly, any future compensation for the carbon pollution reduction scheme may increase measured churning.

A similar example arises in the case of New Zealand, where measured churning is higher than Australia because most benefits are 'grossed-up' before payment and then subject to withholding of income tax. This procedure increases measured churning, but it imposes no administrative burden on households, and it promotes horizontal equity.

Churning is not a measure of economic efficiency. In the case of family payments, it would be possible to replace the present cash payments with refundable tax credits, reducing both the level of transfers and taxation. But if the income-testing parameters of the tax credit were the same as the cash transfer, it would simply reproduce the pre-reform pattern of effective marginal tax rates. It is difficult to see that there would be significant efficiency gains in such a change, even if there were presentational advantages. This would also add very significant additional complexity to the tax system, at a time when simplification is being sought, as experience in the United Kingdom demonstrates (Whiteford, Millar & Mendelson 2003).

It is also important to note that churning is a measure of potential waste only if it is possible to reduce churning and keep the distribution of income unchanged. A policy change that reduces churning but simultaneously changes the distribution of income may or may not be welfare-enhancing. In this context, OECD (1998) points out that while some policy changes could reduce churning they would not leave households unaffected. Publicly funded medical care is an example where access relies on health status rather than income. In such cases, reducing the level of churning would change the distribution of income. Assessment of the desirability of these policy changes would need to take account of these distributional effects, and not simply whether the system appeared to be more efficient. More broadly, what critics describe as churning is from another perspective one of the main objectives of welfare state provision—the 'piggy-bank objective'.

This discussion should not be taken to imply that it is not important to assess whether specific transfer policies and taxation policies are efficient or whether they could be improved. Undoubtedly, it would be possible to improve the efficiency and effectiveness of the tax-transfer system. In addition, it is possible that people may view the source of household income as important—for instance, it is possible that support provided through the tax system might encourage greater work effort compared to support provided through cash transfers—but the extent to which this is the case is not captured by the conventional measures of churning described above. The point of the discussion is that the apparent level of churning by itself is a very limited measure of the scope for reform. Such an assessment needs to be based on a detailed assessment of individual programs, not broad and potentially misleading statistical measures.

3.3 How Much Redistribution Do Welfare States Achieve?

3.3.1 The Accounting Framework for Household Income—and Its Limitations

Targeting and progressivity are both a means to an end, and where the desired result can be to reduce inequality or alleviate poverty. Other ways of expressing these goals include providing a minimally adequate level of income support, but this is just another way of aiming to reduce inequality or poverty. The extent to which governments or societies aim to reduce poverty and inequality can, of course, vary widely.

In seeking to evaluate the distributional outcomes of tax and transfer systems it is necessary to have specific measures of these outcomes and the degree to which these outcomes are affected by tax and transfer arrangements. The social policy literature and much of the economics literature on this topic approach these issues using an accounting framework for analysing the process of income distribution and redistribution (Palme 1990; Esping-Andersen 1990).

³¹ Such differences in household composition are also likely to affect measures of progressivity so that the distribution of transfers will be less progressive in countries where recipients share households with other adult family members.

Following Ringen (1987), this will be called ‘the standard approach’. By definition, using a common framework to analyse income distribution and redistribution across countries implies that the framework is equally applicable in all countries and gives consistent results.

Table 3.7 sets out this standard approach. In this framework, income from wages and salaries, self-employment and property sum to ‘factor income’; factor income plus occupational and private pensions gives ‘market income’; market income plus public and private transfers, as well as other types of cash income, produces ‘gross income’; finally, gross income minus personal income taxes and workers’ social security contributions gives ‘cash disposable income’. This last concept, when adjusted to reflect differences in household needs through an equivalence scale, gives ‘equivalised disposable income’—the main measure of household well-being used in this chapter. The approach set out in Table 3.7 is an accounting framework that allows different components of income to be related to each other and suitable aggregates to be derived but, as discussed below, the framework is both linear and static.

This framework can be used to construct a number of measures of the redistributive impact of social security and taxation policies. With micro-data, this framework can be applied to each household’s income to produce the four income measures identified in Table 3.7. These unit records

can then be aggregated and analysed to produce measures of distribution and redistribution across the population as a whole. In particular, the degree of redistribution effected by taxes or social security transfers can be calculated by comparing income shares or other measures such as Gini coefficients at different stages in the process outlined in Table 3.7. For example, the impact of cash transfers can be evaluated by comparing the difference between measures of inequality or poverty on the basis of market income (Stage 2) and on the basis of gross income (Stage 3), while the effects of taxes can be calculated by comparing measures of gross and disposable incomes (Stage 4). As noted by Ringen (1987, p. 172), this standard approach provides a simple but ingenious and flexible model. Yet despite its widespread use, it has a number of important limitations. These include the counterfactual against which redistribution is assessed; limitations in accounting for government redistributive activity; and the treatment of the relationship between public and private provision.

Any assessment of the distributional impact of a set of policies involves comparing the observed distribution with a counterfactual—the hypothetical distribution that would exist in the absence of the policies being evaluated (Pederson 1994). As set out above, the standard accounting framework is linear: it assumes that the distribution of factor and market incomes precedes the operation of the tax and transfer systems, and there are no interactions between them apart from the direct effect of government programs in reducing final inequality. Moreover, when applied to a range of countries, this approach implicitly assumes that the wide variation in the scope and form of welfare states has no impact on the behaviour of people in these different countries.

Both assumptions are unrealistic. Individuals make decisions about income-generating activities within existing institutional frameworks, which vary widely across countries. Layard (1977), Reynolds and Smolensky (1977) and Piggott (1987) point out that because of these assumptions the standard approach exaggerates both the inequality of market incomes and the amount of redistribution that is achieved by social policies. This chapter attempts to deal with this fundamental problem by providing estimates that include and then exclude the re-ranking effects of the welfare state, showing that this effect is significant.

A second limitation of the standard approach is that the effects of government policies are only partly considered. These gaps arise in several ways. First, most income surveys only include information on cash benefits and direct taxes, while excluding in-kind benefits and consumption taxes (Warren 2008). Second, policies can be implemented through regulations rather than direct provision, and the former are excluded from the analysis. For example, an important way in which governments influence labour market outcomes is through the setting of minimum wages, but in the standard approach the degree of wage dispersion in each country is treated as if it has been produced by market mechanisms alone. Third, the standard framework also excludes employer social security

Table 3.7 The Income Accounting Framework

Income component	Adjustment	Equivalised income component
Wages and salaries		
+		
Self-employment income		
+		
Property income		
=		
1. Factor income	equivalence scales	= equivalent factor income
+		
Occupational and private pensions		
=		
2. Market income	equivalence scales	= equivalent market income
+		
Social security cash benefits (universal, income-related, contributory)		
+		
Private transfers		
+		
Other cash income		
=		
3. Gross income	equivalence scales	= equivalent gross income
–		
Income tax (and employee social security contributions)		
=		
4. Cash disposable income	equivalence scales	= equivalent cash disposable income

Source: Adapted from O’Higgins, Schmaus and Stephenson (1990, pp. 30–1).

contributions which are insignificant in Australia, Denmark and New Zealand but account for more than 25 per cent of total tax revenue in France and the Czech Republic (OECD 2007). Given that these contributions pay for a large part of social security spending in many countries, an assessment of their distributional impact would be warranted.³² The obvious question that arises is whether a different measure of household well-being, broadened to include these factors, would change conclusions about the extent of redistribution in different countries. The answer will depend on the extent to which there is divergence between these income measures in different countries (e.g. on the relative weights of cash transfers and other public spending, and of direct taxes and other forms of taxation).

A further limitation of the standard approach is that public cash transfers (as well as taxes and social security contributions) can substitute for a wide range of private arrangements for individual protection, and vice versa.³³ A case in point arises when considering contributions to private and occupational pensions and their relation to contributions to public pensions. The standard approach treats contributions to government pensions as a tax that finances the retirement pensions paid out in the same year, while contributions to private pensions are effectively treated as if they were a form of private consumption. This affects international comparisons of income distribution in several ways. For example, countries with generous earnings-related social security systems will tend to look more equal because a higher proportion of the savings that well-off individuals make for retirement are made through taxes. Conversely, where flat rate or means-tested benefits are provided, a higher proportion of savings for retirement is made through occupational and private pension contributions.³⁴ In summary, different social security systems produce different distributions of public and private pension rights, and the incomplete treatment of this redistributive activity may bias cross-country comparisons of income distribution. Overcoming this bias requires broadening the framework used to assess household well-being and distributive outcomes.

3.3.2 Levels and Distributions of Cash Transfers and Household Taxes

It is often taken for granted in Australia that because we have a targeted benefit system which is flat rate and means tested, by definition it must be more redistributive than other systems. Indeed, Table 3.5 showed that in some OECD countries the top half of the income distribution receives more than half of all transfers, raising the question of how such systems can possibly reduce inequality and poverty. However, this is a misinterpretation of the potential impact of the welfare state and confuses progressivity with redistribution. The only prerequisite for (static) redistribution to occur is that the distribution of cash transfers (and that of household taxation) be more progressive than the distribution of market income. So long as inequality of transfer receipt is less unequal than inequality of market incomes, then transfers will reduce inequality. In fact, the transfer systems in all OECD countries are less unequal than the market income distribution, so that all social protection systems no matter how regressive they appear to be do reduce inequality.

The degree of redistribution achieved by the tax-benefit system³⁵, however, depends on both the progressivity of taxes and benefits and their size, that is, the level of spending and of revenue collected (Barr 1992).³⁶ By definition, in a means-tested system, benefits provided to the poorest are greater than the average benefits paid. Conversely, a universal, flat rate system provides benefits that are of equal value to all recipients, while under an earnings-related system average benefits are greater than minimum benefits. It follows that, *for a given amount of spending*, benefits paid to those with fewer economic resources will be greater under a means-tested system than under a universal benefit system, which in turn will provide more generous payments to the poor than an earnings-related system.

On the other hand, these characteristics of welfare systems may also impact on the overall size of spending, as the middle class may be more supportive of welfare programs

32 The incidence of employer contributions is debatable, but one straightforward approach is to assume they are incident on wages. Inclusion of employer social security contributions in both market income and household taxes would change both market income inequality and measures of the effectiveness of different tax-transfer systems (Mitchell 1991).

33 As noted by Atkinson (1991), consideration of the effects of social insurance should take account of the possibility of the *equivalence of transactions*: 'Where for instance people are already saving for old age, the introduction of a compulsory government pension scheme on the same terms may simply displace the private savings' (p. 11).

34 These biases can be addressed in several ways. For example, the UK 'Households Below Average Income' statistics subtract occupational pension contributions from disposable income, on the basis that these contributions do not enhance current living standards.

35 A simple example (which disregards the impact of taxes) illustrates the impact of different welfare state arrangements on the distribution of household income. Imagine two countries with the same distribution of market incomes and a concentration coefficient of 0.40. In country A transfers account for 20 per cent of household gross income and the concentration coefficient for transfers is 0.30 (i.e. the system is earnings related, but not as unequal as market income); in this country, market income provides 80 per cent of gross household income and the Gini coefficient for income after transfers is 0.38 (0.40×0.8 plus 0.30×0.2). In country B transfers account for only 5 per cent of gross income, but the concentration coefficient for transfers is zero (i.e. benefits are flat rate) so that the Gini coefficient for income after transfers is also 0.38 (0.40×0.95 plus 0.00×0.05). In this example, the transfer systems of these two countries reduce income inequality by the same degree even though the level of spending and the distribution of benefits were very different in each.

36 There are other influences as well, including the incidence of unemployment by income class and differences in life expectancy and disability by income; other important factors include the take-up of benefits (low take-up reduces effective progressivity) and the coverage of the social security system. As shown in section 3.3.2, Mexico and Turkey have the least redistributive social security systems in the OECD, with the main explanation for this being their lower level of coverage of the population.

when benefits are universally provided (Korpi & Palme 1998). Indeed, in much of the social policy literature, Australia (along with the other English-speaking countries) is viewed as a residual welfare state, providing the lowest level of 'decommodification' of any OECD country (Esping-Andersen 1990). Similarly, a Dutch study of 'the worlds of welfare' concluded that 'Australia has no collective social insurance schemes and is thus a textbook example of a liberal or residual system' (Schut, Vrooman & de Beer 2001, p. 26). The critical question, therefore, relates to the impact of different program designs or distributional profiles when levels of spending and taxes differ across countries.

Table 3.8 shows the level of public cash transfers and of household taxes expressed as a share of household disposable income, and also how these shares have changed since the mid-1990s. Cash benefits are lowest in Korea and Mexico, at 4 per cent and 6 per cent of household disposable income, respectively, while they account for around 9 per cent of household income in the United States. Cash benefits are between 13 per cent and 20 per cent of household disposable income in Australia

(the sixth-lowest level in the OECD), Canada, Finland, Iceland, Ireland, Japan, the Netherlands, New Zealand, Switzerland, Turkey and the United Kingdom; between 20 per cent and 30 per cent in the Czech Republic, Denmark, Germany, Greece, Italy, Norway, Portugal, Spain and the Slovak Republic; and they exceed 30 per cent of household income in Austria, Belgium, France, Hungary, Luxembourg, Poland and Sweden. Since the mid-1990s, benefits have fallen as a share of household income in a majority of these countries, most strongly in Finland and Sweden, following the recovery from the deep recession in the early 1990s, but also in Ireland, due to strong rates of economic growth. Cash benefits have grown in significance, particularly in Turkey and Japan, as well as Germany.

Not surprisingly, cash benefits are most significant for the population of retirement age, amounting on average to two-thirds of their incomes, and to more than 90 per cent in Belgium, France, Italy, Luxembourg and Sweden, and over 100 per cent in Austria. Cash transfers account for only around half of the household income of older people in Australia (the fifth-lowest level in the OECD), Canada,

Table 3.8 Shares of Cash Benefits and Household Taxes in Household Disposable Income, Percentage Shares in the Mid-2000s and Point Changes in These Shares Since the Mid-1990s

	Public cash benefits				Household taxes			
	Working age	Retirement age	Total	Change since mid-1990s	Working age	Retirement age	Total	Change since mid-1990s
	Levels in mid-2000s				Levels in mid-2000s			
Australia	10.1	48.7	14.3	-0.6	24.8	9.7	23.4	-1.4
Austria ^c	27.4	101.3	36.6	-	35.0	27.5	33.4	-
Belgium ^c	22.3	96.9	30.5	-2.1	43.1	19.6	38.3	-
Canada	9.3	46.7	13.6	-4.4	27.0	15.0	25.8	-3.5
Czech Republic ^b	17.0	79.1	24.3	3.2	23.9	6.1	21.6	0.9
Denmark	19.9	81.1	25.6	-5.6	53.8	44.2	52.5	-0.7
Finland	12.4	18.1	14.4	-8.9	31.0	24.8	30.1	-3.7
France ^d	22.6	96.4	32.9	-0.1	28.8	11.1	26.0	0.5
Germany	16.4	82.2	28.2	4.9	41.1	12.5	35.5	-3.5
Greece ^a	16.7	66.4	22.7	3.3	-	-	-	-
Hungary ^a	27.5	85.6	35.1	1.1	-	-	-	-
Iceland	12.3	79.7	19.2	-	54.1	34.2	53.1	-
Ireland ^b	13.3	55.8	17.7	-6.7	20.7	5.4	19.4	-3.6
Italy	21.1	87.4	29.2	0.6	32.0	21.1	30.2	1.2
Japan	11.0	55.8	19.7	8.2	21.0	15.4	19.7	-0.1
Korea	3.0	15.7	3.6	-	8.1	5.0	8.0	-
Luxembourg ^c	22.4	91.0	30.6	-	26.3	14.8	23.8	-
Mexico ^a	5.4	21.3	5.8	2.2	-	-	-	-
Netherlands	12.7	53.0	17.1	-3.5	26.9	10.0	24.7	-6.0
New Zealand	13.1	76.8	13.0	-2.8	29.1	19.8	29.0	-1.5
Norway	15.4	72.7	21.7	0.4	35.0	22.7	33.2	1.3
Poland ^{a,b}	30.4	92.6	35.8	-	28.8	17.9	27.7	-
Portugal ^{a,b}	20.3	74.2	25.5	-1.5	-	-	-	-
Slovak Republic	22.0	86.0	26.0	-	22.0	5.0	20.0	-
Spain ^{a,b}	15.0	70.4	21.3	-2.3	-	-	-	-
Sweden	21.4	96.3	32.7	-5.7	44.2	40.2	43.2	1.2
Switzerland ^b	9.7	63.6	16.0	-	36.6	32.9	36.0	-
Turkey ^a	18.6	46.0	16.9	10.6	-	-	-	-
United Kingdom	8.7	54.3	14.5	-0.5	26.2	10.0	24.1	0.4
United States	5.6	42.1	9.4	-1.5	27.7	16.4	25.6	-1.6
OECD-24 ^e	15.8	69.7	21.9	-1.5	31.1	18.4	29.3	-1.3

Notes: (a) Data on public cash benefits are reported net of taxes (i.e. household taxes not separately identified). (b) Changes refer to the period from the mid-1990s to around 2000. (c) Data for the mid-1990s only available net of household taxes. (d) Data on levels and changes are based on two different sources. (e) OECD-24 is the average of the countries with data on both gross public cash transfers and household taxes (i.e. all countries shown in the table except Greece, Hungary, Mexico, Portugal, Spain and Turkey). -: Data not available.

Source: Computations based on OECD Income Distribution Questionnaire.

Ireland, Japan, the Netherlands, Turkey, the United Kingdom and the United States, and are least significant in Korea, Mexico and, apparently, Finland.³⁷ For households with a working-age head, benefits are much less significant, averaging around 15 per cent of household income, but ranging from 3 per cent to 6 per cent in Korea, Mexico and the United States to 30 per cent in Poland, with Australia at 10 per cent being seventh lowest.

Measured household taxes also vary widely. They are low in Korea but account for more than 40 per cent of household disposable income in Sweden and more than 50 per cent in Denmark and Iceland.³⁸ The level of household taxes—as measured in household surveys—has decreased on average by about 1 percentage point since the middle of the 1990s, matching the decline recorded on the transfer side, with larger declines in the Netherlands, Canada, Germany, Ireland and Finland. It is clear, however, that the relationship between measured taxes and transfers differs

across countries. For example, in the United States—based on the household survey data used there—household taxes (at 26 per cent of household income) are nearly three times higher than cash transfers. At the other extreme, in the Czech Republic, France, Luxembourg and the Slovak Republic, measured transfers account for a larger share of household disposable income than measured taxes. A major factor behind these discrepancies is the fact that employer social security contributions—which finance a large part of the welfare state in these and some other countries—are paid by employers directly to the government, and since they do not pass through the household sector they are not recorded in household income surveys.

Table 3.9 compares OECD countries in terms of how public transfers and household taxes are distributed across income groups. The measure shown is the concentration coefficient, which is calculated in the same way as the Gini

Table 3.9 Progressivity of Cash Benefits and Household Taxes, Concentration Coefficients for Cash Benefits and Direct Taxes, Mid-2000s

	Public cash benefits			Household taxes		
	Working age	Retirement age	Total	Working age	Retirement age	Total
Australia	-0.431	-0.080	-0.400	0.492	0.816	0.533
Austria	0.130	0.256	0.157	0.365	0.464	0.381
Belgium	-0.141	0.169	-0.120	0.363	0.420	0.398
Canada	-0.173	-0.006	-0.152	0.472	0.586	0.492
Czech Republic	-0.151	0.037	-0.154	0.424	0.789	0.471
Denmark	-0.303	-0.054	-0.316	0.332	0.336	0.349
Finland	-0.258	-0.138	-0.219	0.419	0.444	0.428
France	0.098	0.285	0.136	0.354	0.474	0.374
Germany	-0.066	0.175	0.013	0.439	0.485	0.468
Greece ^a	0.176	0.202	0.115	—	—	—
Hungary ^a	-0.025	0.119	-0.016	—	—	—
Iceland	0.018	0.037	-0.041	0.257	0.296	0.267
Ireland	-0.205	-0.001	-0.214	0.531	0.782	0.570
Italy	0.158	0.225	0.135	0.512	0.623	0.546
Japan	0.020	0.121	0.010	0.356	0.429	0.378
Korea	0.040	0.282	-0.012	0.363	0.462	0.380
Luxembourg	0.075	0.145	0.085	0.404	0.430	0.420
Mexico ^a	0.407	0.518	0.373	—	—	—
Netherlands	-0.223	-0.014	-0.198	0.436	0.705	0.471
New Zealand	-0.331	-0.011	-0.345	0.485	0.249	0.498
Norway	-0.177	0.074	-0.183	0.355	0.433	0.376
Poland	0.173	0.198	0.185	0.382	0.325	0.379
Portugal ^a	0.315	0.295	0.247	—	—	—
Slovak Republic	-0.030	0.104	-0.056	0.388	0.726	0.422
Spain ^a	0.102	0.175	0.063	—	—	—
Sweden	-0.153	0.090	-0.145	0.330	0.312	0.337
Switzerland	-0.176	0.015	-0.170	0.211	0.202	0.223
Turkey ^a	0.320	0.288	0.347	—	—	—
United Kingdom	-0.347	0.035	-0.275	0.486	0.614	0.533
United States	-0.115	0.105	-0.089	0.549	0.658	0.586
OECD-24 ^b	-0.107	0.085	-0.099	0.404	0.502	0.428

Notes: The concentration coefficient is computed in the same way as the Gini coefficient of household income, so that a value of zero means that all income groups receive an equal share of household transfers or pay an equal share of taxes. However, individuals are ranked by their equivalised household disposable incomes. (a) Data on public cash benefits are reported net of taxes (i.e. household taxes are not separately identified). (b) OECD-24 is the average of the countries with data on both gross public cash transfers and household taxes (i.e. all countries shown in the table except Greece, Hungary, Mexico, Portugal, Spain and Turkey). —: Data not available.

Source: Computations based on OECD Income Distribution Questionnaire.

37 The apparently low level of public cash benefits to the retirement-age population in Finland reflects the fact that, in the income questionnaire used by the OECD, mandatory occupational pensions are counted as a private transfer (hence included in capital incomes) rather than as government cash transfers.

38 Taxes paid by people of retirement age are by far the highest in Denmark, taking 44 per cent of their household disposable income, followed by Sweden, Iceland and Switzerland.

coefficient, except that households are ranked by their disposable incomes. Because individuals are ranked according to their disposable income, rather than by the public transfers they receive, the concentration coefficient of transfers ranges between plus 1 and minus 1, with zero implying that transfers are flat rate; negative values occur in the case where poorer income groups receive a higher share of transfers than their share of disposable income, so that lower and more negative values imply greater progressivity.

As noted earlier, cash benefits are more progressively distributed than market incomes in all countries, thus reducing inequality. The distribution of cash benefits for the entire population is most progressive, by a wide margin, in Australia, followed by New Zealand, Denmark, the United Kingdom, Finland and Ireland, while it is least progressive in Mexico, Turkey, Portugal, and Poland. With the exception of Portugal and Turkey, transfers to people of working age are more progressively distributed than those to people of retirement age, and again Australia has the most progressive distribution by a wide margin. The ranking of countries is broadly similar for transfers to people of retirement age and of working age, although Finland has the most progressive distribution of transfers to people of retirement age, rather than Australia.

The progressivity of transfers varies significantly also across different types of benefits, with the highest

progressivity being for housing benefits (because they tend to be income-related), 'other benefits' (which includes social assistance), unemployment payments and family cash benefits (Table 3.10). Housing benefits are most progressively distributed in the Nordic countries, while family benefits are most progressive in the United States and other English-speaking countries, where income testing is more common. Australia has the most progressive distribution of disability benefits, unemployment benefits and survivor benefits, the second-most progressive distribution of age pensions and the fifth-most progressive distribution of family payments. It should be noted, however, that while the United States and Italy have the most progressive distribution of family benefits, this does not include tax rebates or deductions for children, which would substantially change measured progressivity if included.

Tables 3.11 to 3.14 show trends in the concentration coefficient for transfers from the 1980s to 2000. Overall, Australia has always over this period had the most progressive distribution of transfers, and progressivity has also increased in Australia. Transfers have become somewhat less progressive in the United States and Canada, and more progressively distributed in the Nordic countries apart from Norway, and in the Netherlands and New Zealand. Similar broad trends apply in the case of

Table 3.10 Progressivity of Cash Transfers by Program, Concentration Coefficients for Cash Transfers, Mid-2000s

	Old age pensions	Disability benefits	Compensation for occupation injury and diseases	Survivor benefits	Family cash benefits	Unemployment benefits	Housing benefits	Other benefits
Australia	-0.47	-0.35	–	-0.30	-0.33	-0.44	–	-0.40
Austria	0.25	0.14	0.16	0.00	-0.09	-0.17	-0.48	-0.05
Belgium	-0.09	-0.27	-0.13	-0.14	0.03	-0.22	-0.15	-0.50
Canada	-0.11	–	–	–	-0.46	-0.06	–	-0.22
Czech Republic	-0.11	-0.06	–	0.19	-0.26	-0.28	-0.66	-0.36
Denmark	-0.49	-0.18	–	–	-0.04	-0.22	-0.58	-0.37
Finland	-0.44	0.07	0.12	0.02	-0.07	-0.24	-0.61	-0.39
France	0.25	0.14	–	0.05	-0.13	0.08	-0.55	-0.23
Germany	0.10	–	0.07	-0.04	-0.04	-0.28	0.00	-0.24
Greece	0.15	0.06	0.25	0.02	-0.02	0.04	-0.17	-0.11
Hungary	0.01	–	–	–	-0.06	-0.25	–	-0.17
Ireland	-0.32	-0.27	0.27	0.08	-0.21	-0.07	-0.46	0.02
Italy	0.22	0.90	–	–	-0.52	-0.04	–	-0.05
Japan	0.02	–	–	–	–	-0.11	–	-0.33
Luxembourg	0.17	0.00	–	0.13	-0.02	-0.09	-0.41	-0.52
Netherlands	-0.16	-0.11	–	-0.14	-0.36	0.03	-0.65	-0.37
New Zealand	-0.32	-0.35	-0.41	0.02	-0.43	-0.38	-0.37	-0.14
Norway	-0.27	-0.06	–	-0.18	-0.06	-0.12	-0.65	-0.24
Poland	0.26	0.04	0.40	0.15	-0.22	0.13	-0.26	-0.13
Portugal	0.33	0.03	–	0.03	–	0.20	0.13	-0.77
Slovak Republic	0.00	-0.19	-0.01	0.24	-0.01	-0.07	0.84	-0.59
Spain	0.04	0.11	0.14	0.05	0.35	0.02	0.48	0.02
Sweden	-0.19	0.25	0.25	–	-0.07	-0.10	-0.66	-0.16
Switzerland	-0.19	–	–	–	-0.02	-0.15	–	-0.29
Turkey	0.37	0.07	–	0.25	0.17	0.08	–	0.52
United Kingdom	-0.21	-0.20	–	–	–	–	–	-0.37
United States	-0.04	–	–	–	-0.56	0.07	–	-0.10
OECD-27	-0.05	-0.01	0.10	0.02	-0.14	-0.10	-0.29	-0.24

Notes: Data refer to the mid-2000s for all countries. Data refer to 'gross' public cash transfers (i.e. before taxes) for all countries except Greece, Hungary, Ireland, Mexico, Poland, Portugal, Spain and Turkey (where survey data on transfers are reported net of taxes). OECD-27 is the average across all countries with data available. –: Data not available.

Source: Computations based on OECD Income Distribution Questionnaire.

Table 3.11 Progressivity of Transfers, Entire Population, OECD Countries, 1980s to 2000, Concentration Coefficient

	1980s	1990s	2000
Australia	-34.1	-38.1	-38.3
Austria	-4.1	-0.5	-6.0
Belgium	-5.9	-7.4	-7.4
Canada	-16.2	-13.2	-12.0
Czech Republic	–	-22.9	-18.9
Denmark	-18.3	-24.6	-29.2
Finland	-18.8	-16.9	-23.0
France	2.1	4.3	-3.0
Germany	-2.1	-5.0	-1.3
Greece	21.7	14.1	17.2
Hungary	–	-1.3	-6.0
Ireland	-19.3	-23.2	-22.6
Italy	1.5	18.1	14.8
Japan	7.9	1.0	3.2
Luxembourg	1.4	1.8	-8.2
Mexico	67.9	37.7	37.1
Netherlands	-14.1	-19.1	-22.1
New Zealand	-22.3	-29.7	-30.7
Norway	-22.3	-21.3	-20.6
Poland	–	7.6	5.9
Portugal	–	12.7	15.1
Spain	5.7	6.5	5.4
Sweden	-5.3	-9.8	-14.3
Switzerland	–	4.4	5.9
Turkey	26.7	26.4	21.3
United Kingdom	-29.1	-27.1	-28.6
United States	-13.1	-10.2	-8.8
OECD -27	-4.1	-5.0	-6.5

Note: –: Data not available.

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

Table 3.12 Progressivity of Transfers to People of Working Age, OECD Countries, 1980s to 2000, Concentration Coefficient

	1980s	1990s	2000
Australia	-36.4	-41.6	-42.4
Austria	8.0	3.4	-1.6
Belgium	–	-9.5	-9.5
Canada	-16.8	-16.5	-11.2
Czech Republic	–	-22.1	-18.6
Denmark	-13.9	-22.9	-28.1
Finland	-16.1	-20.6	-27.2
France	-3.5	-7.8	-7.1
Germany	-1.8	-12.8	-6.5
Greece	24.3	16.2	21.8
Hungary	–	-0.6	-6.4
Ireland	-20.0	-26.2	-24.1
Italy	4.8	20.6	19.6
Japan	8.8	2.2	3.3
Luxembourg	0.7	-2.2	-3.4
Mexico	62.9	37.6	43.8
Netherlands	-15.8	-21.6	-26.3
New Zealand	-24.9	-35.3	-37.1
Norway	-17.3	-20.3	-18.3
Poland	–	6.4	4.5
Portugal	–	19.2	18.4
Spain	6.6	6.4	8.4
Sweden	-2.2	-12.0	-15.2
Switzerland	–	2.5	-5.0
Turkey	24.8	23.5	21.3
United Kingdom	-32.1	-32.7	-35.4
United States	-19.3	-14.0	-12.6
OECD-27	-3.8	-6.7	-7.2

Note: –: Data not available.

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

Table 3.13 Progressivity of Family Cash Benefits and Unemployment Benefits, OECD Countries, 1980s to 2000, Concentration Coefficient

	Family cash benefits			Unemployment benefits		
	1980s	1990s	2000	1980s	1990s	2000
Australia	-20.9	-48.4	-47.3	-46.5	-39.0	-44.9
Austria	-1.4	-2.5	-14.0	-5.7	-23.4	-33.0
Belgium	–	5.2	–	–	-38.5	–
Canada	-24.3	-41.6	-53.6	-4.4	0.5	-6.0
Czech Republic	–	-27.0	-33.4	–	-32.9	-22.4
Denmark	-23.3	-12.2	-13.0	-5.9	-17.4	-23.7
Finland	-11.7	-5.3	-12.6	-22.6	-24.0	-30.4
France	-44.1	-53.9	-19.2	-0.8	7.4	-6.7
Germany	-9.0	-13.5	-6.0	-26.9	-26.4	-19.8
Greece	-7.5	-1.4	-2.9	2.4	6.2	21.8
Hungary	–	-10.3	-13.5	–	-34.2	-35.9
Ireland	-15.0	-22.8	-24.4	-28.5	-38.3	-36.1
Italy	–	–	–	–	–	–
Japan	–	–	–	–	–	–
Luxembourg	-16.2	-11.5	-11.9	-1.6	-31.7	-5.3
Mexico	–	–	–	–	–	–
Netherlands	-20.7	-19.1	-20.3	-7.5	-2.8	-9.3
New Zealand	-35.5	-52.4	-52.2	-39.0	-35.8	-40.8
Norway	-15.4	-12.2	-11.8	–	-12.8	-21.0
Poland	–	-11.2	-10.8	–	-19.9	-17.7
Portugal	–	–	-7.9	–	–	15.6
Spain	–	–	–	-5.9	-4.4	-10.0
Sweden	-3.4	-13.7	-15.1	-13.7	-17.2	-20.1
Switzerland	–	-7.2	-8.9	–	-19.4	-24.7
Turkey	–	–	–	–	–	-7.6
United Kingdom	-26.7	-20.6	-51.8	-67.7	-58.9	-60.8
United States	-58.5	-53.5	-59.5	0.3	7.2	0.6
OECD-27	-20.8	-21.7	-23.3	-17.1	-20.1	-19.0

Note: –: Data not available.

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

Table 3.14 Progressivity of Transfers to Pensioners, OECD Countries, 1980s to 2000, Concentration Coefficient

	1980s	1990s	2000
Australia	-7.0	-1.8	-6.1
Austria	-12.6	-2.0	17.3
Belgium	–	22.2	22.2
Canada	0.0	1.2	-0.6
Czech Republic	–	4.1	3.7
Denmark	-1.1	-2.9	-5.6
Finland	-5.8	-1.2	-11.9
France	26.9	25.6	23.9
Germany	21.3	19.8	18.0
Greece	26.4	27.2	23.6
Hungary	–	8.8	9.2
Ireland	-4.9	3.9	2.9
Italy	8.6	21.4	20.7
Japan	8.4	8.7	11.0
Luxembourg	12.6	10.8	12.5
Mexico	65.1	44.3	44.6
Netherlands	1.1	0.3	-0.9
New Zealand	1.9	-0.2	-0.1
Norway	6.6	7.8	6.9
Poland	–	10.7	10.6
Portugal	–	21.2	28.5
Spain	13.4	14.1	13.0
Sweden	19.5	13.2	12.5
Switzerland	–	19.4	19.2
Turkey	36.0	32.4	21.5
United Kingdom	-0.5	2.1	2.6
United States	6.9	9.5	11.5
OECD-27	10.6	11.9	12.0

Notes: Data for Switzerland refer to ODSB which is old-age cash, disability and survivor benefits. –: Data not available.

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

transfers to working-age households. Family cash benefits have become significantly more progressive in Australia, Canada, New Zealand and the United Kingdom.

The second panel of Table 3.9 shows the distribution of household taxes (income taxes and employee social security contributions). Because taxes are deducted from household incomes, higher values of the concentration coefficient imply a more progressive distribution of household taxes. Taxation is most progressively distributed in the United States, probably reflecting the greater role played there by refundable tax credits, such as the Earned Income Tax Credit and the Child Tax Credit. Overall, there is less variation in the progressivity of taxes across countries than in the case of transfers. After the United States, the distribution of taxation tends to be most progressive in the English-speaking countries—Ireland, Australia, the United Kingdom, New Zealand and Canada—together with Italy, followed by the Netherlands, the Czech Republic and Germany. Taxes tend to be least progressive in the Nordic countries, France and Switzerland. In most but not all countries, taxes are more progressive for the retirement-age population than for the working-age population, reflecting the existence of various tax concessions for low-income retired people. Australia has the most progressive distribution of taxes for people in retirement-age households—put another way, most households of retirement age in Australia pay little or no taxes.

However, the progressivity of the tax system also depends on the level of inequality of taxable income, and the effective progressivity of a given tax schedule will be greater in a country with a more unequal distribution of

Table 3.15 Alternative Measures of Progressivity of Taxes in OECD Countries, 2005

	A. Concentration of household taxes and market income			B. Percentage share of richest decile		
	1. Concentration coefficient for household taxes	2. Gini coefficient of market income	3. Ratio of concentration coefficients (1/2)	1. Share of taxes of richest decile	2. Share of market income of richest decile	3. Ratio of shares for richest decile (1/2)
Australia	0.53	0.46	1.16	36.8	28.6	1.29
Austria	0.38	0.43	0.88	28.5	26.1	1.10
Belgium	0.40	0.49	0.80	25.4	27.1	0.94
Canada	0.49	0.44	1.13	35.8	29.3	1.22
Czech Republic	0.47	0.47	0.99	34.3	29.4	1.17
Denmark	0.35	0.42	0.84	26.2	25.7	1.02
Finland	0.43	0.39	1.11	32.3	26.9	1.20
France	0.37	0.48	0.77	28.0	25.5	1.10
Germany	0.47	0.51	0.92	31.2	29.2	1.07
Iceland	0.27	0.37	0.72	21.6	24.0	0.90
Ireland	0.57	0.42	1.37	39.1	30.9	1.26
Italy	0.55	0.56	0.98	42.2	35.8	1.18
Japan	0.38	0.44	0.85	28.5	28.1	1.01
Korea	0.38	0.34	1.12	27.4	23.4	1.17
Luxembourg	0.42	0.45	0.92	30.3	26.4	1.15
Netherlands	0.47	0.42	1.11	35.2	27.5	1.28
New Zealand	0.50	0.47	1.05	35.9	30.3	1.19
Norway	0.38	0.43	0.87	27.4	28.9	0.95
Poland	0.38	0.57	0.67	28.3	33.9	0.84
Slovak Republic	0.42	0.46	0.92	32.0	28.0	1.14
Sweden	0.34	0.43	0.78	26.7	26.6	1.00
Switzerland	0.22	0.35	0.63	20.9	23.5	0.89
United Kingdom	0.53	0.46	1.16	38.6	32.3	1.20
United States	0.59	0.46	1.28	45.1	33.5	1.35
OECD-24	0.43	0.45	0.96	31.6	28.4	1.11

Source: Computations based on OECD Income Distribution Questionnaire.

taxable income. Table 3.15 adjusts for this effect by showing the concentration coefficient of household taxes divided by the Gini coefficient for market income (in the third column), as well as the share of taxes paid by the richest 10 per cent of the population compared to the share of market income they receive (sixth column). Based on the concentration coefficient of household taxes, the United States has the most progressive tax system and collects the largest share of taxes from the richest 10 per cent of the population. However, the richest decile in the United States has one of the highest shares of market income of any OECD country. Standardising for this underlying inequality has some effect but not a major one. Ireland has the most progressive tax system as measured by the ratio of the concentration coefficients of household taxes and market income, with the United States and Australia still coming in at second and third positions respectively, while Australia and the United States collect the most tax from people in the top decile relative to the share of market income that they earn.

What is the relationship between the level of public spending on cash transfers and the progressivity of spending programs? In other words, do OECD countries with more progressive cash programs spend more or less than others? Figure 3.6, which plots the share of public cash transfers as a percentage of equivalised household disposable income as measured in surveys against their level of concentration in different OECD countries, provides some indication. The figure suggests the existence of a negative relationship between progressivity and spending levels, with higher levels of spending associated with lower progressivity (so, for example, the countries in the bottom left of the figure tend to spend less but have more progressive systems). However, lower-income OECD countries such as Mexico and Turkey (which, together with Korea, are excluded from the figure because of their less comprehensive welfare systems) combine both lower levels of spending and low progressivity.

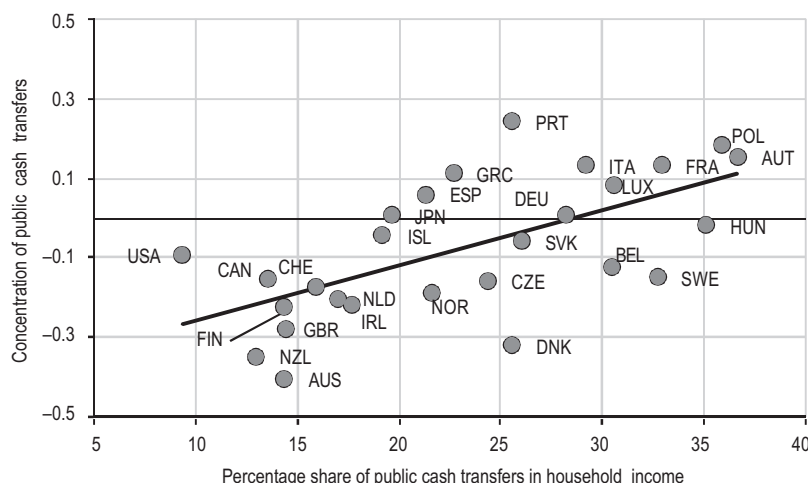
3.3.3 How Much Redistribution Is Achieved Through Government Cash Benefits and Household Taxes?

The most direct way to illustrate the effect of public cash transfers and household taxes on the distribution of household disposable income is to compare the same inequality measure computed over the various income concepts described in Table 3.7. While such comparisons will reflect differences in both size and structure of welfare programs and tax systems across countries, they provide a convenient summary measure that is useful for comparing countries and assessing changes over time. This section presents evidence limited to those OECD countries with data covering both household taxes and gross public transfers (twenty-four countries in the most recent year, excluding Greece, Hungary, Iceland, Mexico, Poland, Portugal, Spain and Turkey for analysis of levels; nineteen countries, that is, also excluding Austria, Belgium, Czech Republic, Korea and the Slovak Republic, for analysis of changes since 1995).

Figure 3.7 shows two measures of the ‘effectiveness’ of the tax and benefit systems in reducing income inequality: the percentage reduction in income inequality when moving from market income to disposable income (in the top panel), and the absolute point difference between these two measures (in the bottom panel). These measures are calculated in two ways:

- » In the first approach (shown as diamonds), inequality in the distribution of market income is computed by ranking people by their level of market income. On this measure, on average, across the twenty-four countries covered, the tax and transfer systems lower income inequality by around one-third (i.e. around 0.15 Gini points), with declines ranging from around 45 per cent in Denmark, Sweden and Belgium to less than 8 per cent in Korea.
- » In the second approach (shown as bars) the Gini coefficient for market income is based on people

Figure 3.6 Level and Concentration of Public Cash Transfers in OECD Countries, Mid-2000s



Source: Computation based on OECD Income Distribution Questionnaire.

ranked by their disposable income, that is, individuals are ranked by where they end up 'after' redistribution, rather than where they were placed 'before' redistribution. On this second measure, the reduction of inequality achieved by taxes and transfers is a little more than one-fourth (i.e. 0.11 points), with declines ranging from around 40 per cent in Sweden and Denmark to 5 per cent in Korea.

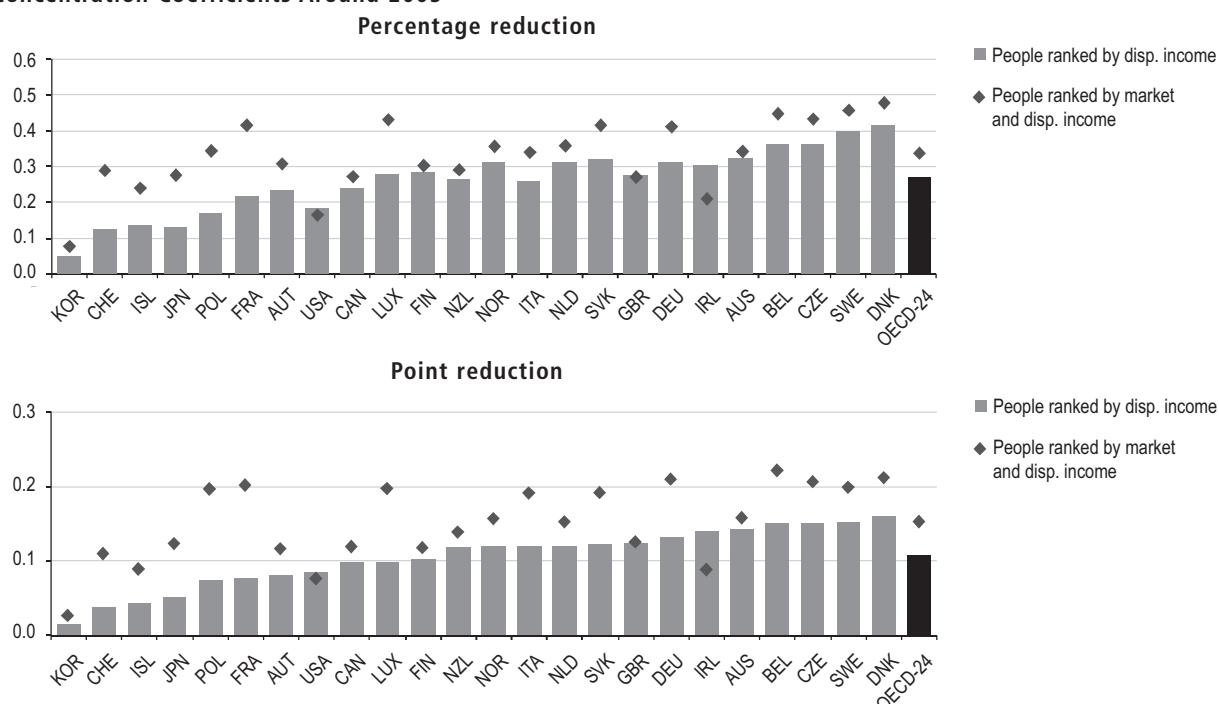
The difference between the two measures of redistribution is a result of the re-ranking of some households as a consequence of welfare state programs (Ankrom 1993). This difference is of interest because one of the limitations of the standard approach to measuring redistribution relates to the counterfactual against which redistribution is measured. Layard (1977), for example, argues that the standard approach exaggerates the redistributive impact of the welfare state because it assumes that the different levels of welfare state spending and taxation have no behavioural impact on the distribution of market incomes. In particular, in countries with generous public pensions, the standard approach implies that middle class individuals are plunged into market income poverty on retirement simply because it is the government, rather than the market, that provides their pensions: generous earnings-related public pensions are then measured as being very effective at reducing inequality, in part because they restore middle-income retirees to their pre-retirement ranking. A comparison between the two alternative measures suggests that, in

some OECD countries, a very significant part of the redistribution measured by the standard approach reflects such a re-ranking of people. In particular, the countries where the re-ranking effect is most significant are precisely those where public pensions account for more than 90 per cent of the total disposable income of the retirement-age population (i.e. Austria, Belgium, France, Italy, Luxembourg and Sweden). In contrast, re-ranking is lower in Korea, the United States, Canada, Finland, the United Kingdom, Ireland and Australia, where public pensions are 50 per cent or less of the disposable income of the retired.

Countries that achieve the largest redistribution through taxes and transfers generally record the lowest inequality in the distribution of household disposable income, although with considerable variation across countries. For example, the level of disposable-income inequality in Iceland and Switzerland is similar to that in Belgium and the Czech Republic, even though the impact of the welfare state is significantly greater in the second two countries. Also, Sweden and Denmark record reductions in inequality that are nearly twice as large as that of the United States, and achieve a level of disposable-income inequality that is around half of that recorded in the United States.

It is also possible to compare the size of the redistribution achieved by each of the two levers. Different approaches can be used for this purpose, but their implementation differs in terms of data requirements, and they can lead to different conclusions. One simple method,

Figure 3.7 Differences in Inequality Before and After Taxes and Transfers in OECD Countries, Difference in Concentration Coefficients Around 2005



Note: Countries are ranked from left to right in increasing order of the percentage point reduction in the concentration coefficient achieved by household taxes and public cash transfers, based on people ranked by their household disposable income. Bars are computed based on grouped data for average market and disposable income, by deciles of people ranked by their household disposable income. Diamonds are computed based on individual data, with people ranked by market income (for the Gini coefficient of market income) and ranked by disposable income (for the Gini coefficient of disposable income).

Source: OECD Income Distribution Questionnaire.

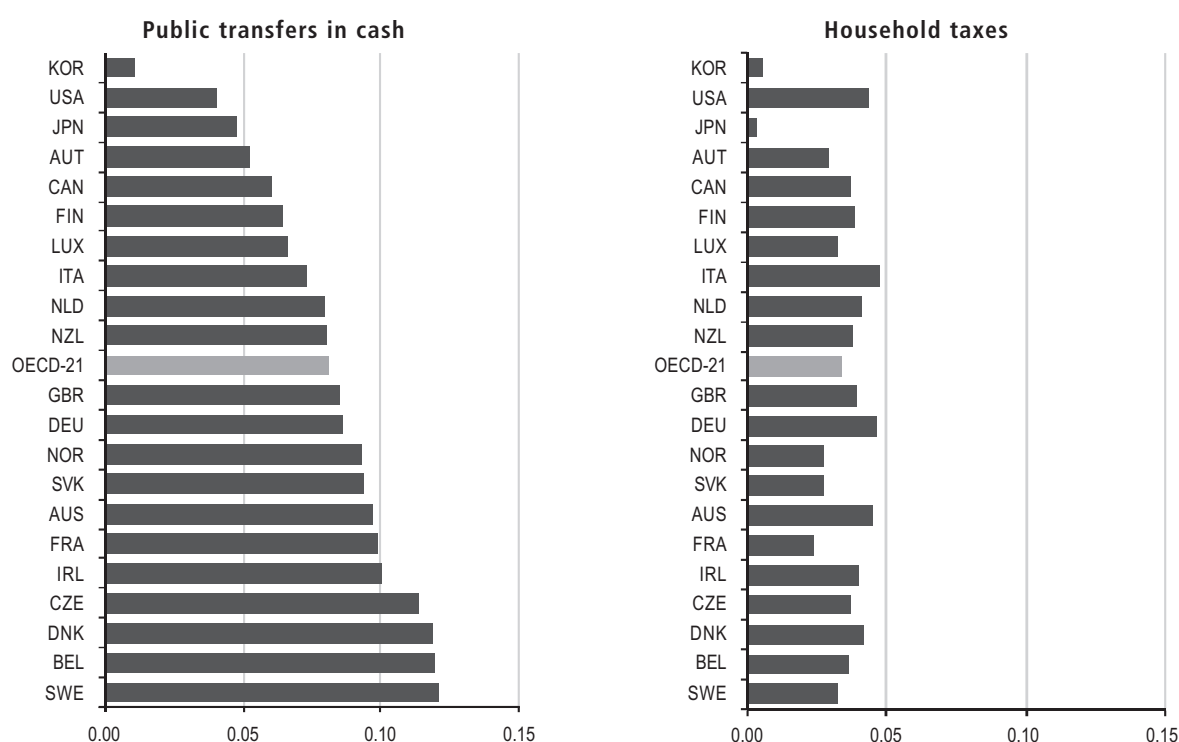
which can be applied with the available data, is to look at the difference between the concentration coefficients for market income and for gross post-transfer income as a measure of the impact of cash transfers; and at the difference between the concentration coefficients for gross post-transfer income and for disposable income as a measure of the impact of household taxes (Figure 3.8).³⁹ For the purposes of consistency with the preferred measure used in Figure 3.7, when calculating inequality in both market and disposable income, people are ranked by their disposable incomes, so that the re-ranking effect discussed above is eliminated. Based on this approach, the redistribution achieved by public cash transfers on average is twice as large as that achieved through household taxes, although the United States stands out for achieving greater redistribution through the tax system than through cash transfers. Korea and Japan also stand out for the very low redistribution achieved through the tax system.

Based on the preferred measure of redistribution (bars in Figure 3.7), which abstracts from the effect of ‘re-ranking’, the combined effect of transfers and taxes in reducing inequality is similar in Ireland and Australia to that achieved

in Sweden and Denmark, while the redistribution in the United Kingdom and in New Zealand is similar to the levels achieved in Germany and the Netherlands, for example. It follows that the *higher levels of disposable-income inequality* in these four English-speaking countries do not reflect *less effective welfare states but higher market-income inequality*, in particular of household earnings, to start with.⁴⁰ In contrast, the United States has a relatively high level of income inequality because it starts with a relatively high level of market income inequality, and this is not as significantly reduced by its transfer system as other countries.

A further way of assessing the impact of differing welfare state arrangements is shown in Table 3.16, which provides measures of the effectiveness and efficiency of tax and transfer systems in reducing inequality. Following Beckerman (1979), effectiveness is defined as the percentage point reduction in the concentration coefficient of income inequality associated with the household taxes and public cash transfers, respectively, in each OECD country, while efficiency is the effectiveness measure (multiplied by 100) divided by the share in household disposable income of household taxes and public cash transfers, respectively.

Figure 3.8 Reduction in Inequality Due to Public Cash Transfers and Household Taxes, Point Reduction in the Concentration Coefficient



Notes: The effect of public cash transfers in reducing income inequality is measured as the difference between the concentration coefficient of market income and that of gross income after transfers, and the effect of household taxes as the difference between the concentration coefficient of gross post-transfer income and that of disposable income. Concentration coefficients are computed based on information on the income share of transfers and taxes, with individuals ranked by their level of equivalised household disposable income.

Source: OECD Income Distribution Questionnaire.

39 These concentration coefficients are computed based on information on the average income by decile—with people ranked by the level of their equivalised disposable income—rather than on micro-data. In general, results based on approaches that ‘add in’ one component after the other depend on the order in which income sources are considered. This is because the calculated contribution of each income source will depend on both its own distribution and the degree to which it is correlated to other income sources. All approaches based on the ‘adding in’ of various income sources—such as the one used in this section—attribute the effect on inequality due to this correlation to the income source that is added last (in this case, household taxes).

40 Household earnings inequality is high in these four countries in part because of wider wage dispersion, but also because a higher share of the population of working age lives in jobless households.

Effectiveness is therefore a measure of how much the tax and transfer systems change the distribution of incomes. Efficiency is measured as effectiveness standardised by how much is spent. For example, in Australia for each 1 percentage point of household taxes, the concentration coefficient for gross income is reduced by 0.193 percentage points, while for each 1 percentage point of public cash transfers, market-income inequality is reduced by 0.679 percentage points (Panel C).

The table suggests that, based on the measure of 'effectiveness' shown in Panel A, the tax system achieves the largest reductions of income inequality in Italy, Germany, Australia, the United States, Denmark, Ireland and the Netherlands, and the lowest ones in Japan, Korea and Switzerland (second column). When looking at public cash transfers, the largest reductions of income inequalities are recorded by Sweden, Belgium, Denmark and the Czech Republic, and the lowest ones in Korea and the United States (third column). The Australian transfer system is the sixth-most effective in the OECD at reducing inequality and the tax system is the third-most effective. The United States in contrast has the fourth-most effective tax system, but the second-least effective transfer system.

Overall, the efficiency measure gives a slightly different picture than some earlier measures. It remains the case that transfer systems are significantly more efficient than tax systems at reducing inequality, as well as more effective,

but some countries change their ranking when the efficiency index is used rather than the concentration coefficients. For example, Australia has a slightly less progressive tax system than the United States (Panel D), but is slightly more efficient in terms of inequality reduction (Panel C). In terms of inequality reduction, Australia has both the most efficient system of transfers in the OECD and the most efficient system of direct taxes. Other countries with highly efficient transfer systems include New Zealand, the United Kingdom and Ireland, while the least efficient transfers are in Austria and France.

The table also shows the correlation between various design features of OECD welfare states. Not surprisingly, the highest correlations are between the concentration and efficiency of household taxes (Panel D), and also between the concentration and efficiency of public cash transfers (in this case, the correlation is negative because the most progressive transfer systems have negative concentration coefficients, as discussed earlier). There are moderately high correlations between the other measures shown, although effectiveness and efficiency are more strongly correlated in the case of taxes than for transfers.

3.3.4 Redistribution towards Those at the Bottom of the Income Distribution

When considering the redistributive effects of the tax and transfer systems it is important to note that the concentration

Table 3.16 Effectiveness and Efficiency of Taxes and Transfers in Reducing Inequality

	A. Effectiveness (inequality reduction)		B. Size (share of household disp. income)		C. Efficiency index A/(B/100)		D. Concentration index	
	Household taxes	Public cash transfers	Household taxes	Public cash transfers	Household taxes	Public cash transfers	Household taxes	Public cash transfers
Australia	0.045	0.097	23.4	14.3	0.193	0.679	0.533	-0.400
Austria	0.029	0.052	33.4	36.6	0.086	0.142	0.381	0.157
Belgium	0.037	0.119	38.3	30.5	0.096	0.391	0.398	-0.120
Canada	0.037	0.060	25.8	13.6	0.145	0.444	0.492	-0.152
Czech Republic	0.037	0.114	21.6	24.3	0.170	0.468	0.471	-0.154
Denmark	0.042	0.118	52.5	25.6	0.080	0.461	0.349	-0.316
Finland	0.038	0.065	30.1	14.4	0.127	0.449	0.428	-0.219
France	0.020	0.056	26.0	32.9	0.079	0.171	0.374	0.136
Germany	0.046	0.086	35.5	28.2	0.130	0.303	0.468	0.013
Ireland	0.041	0.100	19.4	17.7	0.210	0.565	0.570	-0.214
Italy	0.047	0.073	30.2	29.2	0.156	0.251	0.546	0.135
Japan	0.003	0.048	19.7	19.7	0.015	0.244	0.378	0.010
Korea	0.005	0.011	8.0	3.6	0.067	0.312	0.380	-0.012
Luxembourg	0.032	0.066	23.8	30.6	0.135	0.215	0.420	0.085
Netherlands	0.041	0.080	24.7	17.1	0.166	0.468	0.471	-0.198
New Zealand	0.038	0.080	29.0	13.0	0.132	0.615	0.498	-0.345
Norway	0.027	0.093	33.2	21.7	0.082	0.427	0.376	-0.183
Slovak Republic	0.028	0.094	20.0	26.0	0.138	0.361	0.422	-0.056
Sweden	0.032	0.121	43.2	32.7	0.075	0.368	0.337	-0.145
Switzerland	-0.012	0.057	36.0	16.0	-0.034	0.355	0.223	-0.170
United Kingdom	0.039	0.085	24.1	14.5	0.164	0.586	0.533	-0.275
United States	0.044	0.041	25.6	9.4	0.170	0.434	0.586	-0.089
OECD-22	0.032	0.078	28.3	21.4	0.117	0.396	0.438	-0.114
Memorandum items								
Correlation coeff. ^a	-	0.496	0.211	0.423	0.839	0.430	0.906	-0.940

Notes: The effectiveness index is defined as the percentage point reduction in the Gini coefficient of income inequality due to household taxes (i.e. between gross and disposable income) and cash transfers (i.e. between market and gross income) in each OECD country. The efficiency index is the effectiveness index of taxes and transfers divided by the respective share of taxes and transfers in each country. The concentration index of household taxes and public cash transfer is calculated as in Table 3.9. (a) Correlation between effectiveness of taxes and of cash transfers in the second column; between size and effectiveness of taxes and transfers, respectively, in the third and fourth columns; between the efficiency index and effectiveness of taxes and transfers, respectively, in the fifth and sixth columns; and between the concentration index and the efficiency index of taxes and transfers, respectively, in the seventh and eighth columns.

Source: Computations based on OECD Income Distribution Questionnaire.

coefficient gives greater weight to changes in the middle of the distribution, whereas policy-makers may be more concerned about people at the bottom of the income distribution. Beyond looking at changes in poverty rates, it is possible to address this concern by considering the effect of public cash transfers and household taxes on the lowest income groups. Table 3.17 provides a measure of the redistribution towards people at the lower end of the income distribution—in the lowest income quintile—separately for gross public transfers (left-hand panel) and household taxes (right-hand panel).

The role of cash transfers in supporting the income of people in the bottom quintile is computed by first estimating the average ratio of cash transfers as a percentage of household disposable income measured in income surveys (Column A)⁴¹; second, by calculating how much of this share goes to the poorest 20 per cent of the population (Column B); and finally, by multiplying the size of spending by the progressivity of its distribution to calculate gross benefits accruing to people at the lower end of the distribution (divided by 100, in Column C). The same procedure is used to calculate how much tax is paid by

people at the lower end of the distribution, while the difference between the two values (in Column G) represents the 'net' cash transfers to the lowest income quintile.

Several patterns stand out in Table 3.17:

- » First, public cash transfers are more targeted to the poorest 20 per cent of the population in Australia, Denmark, New Zealand, Finland, the Netherlands, Ireland and the United Kingdom (in these countries the lowest income quintile receives more than 30 per cent of all transfers, and above 40 per cent in Australia, Column B), and least targeted in Poland (where the poorest 20 per cent receives less than 10 per cent of all transfers). On this criterion, the level of targeting is roughly similar in Canada, the United States and Sweden.
- » Second, there are large differences in the overall size of the redistribution towards low income households achieved through the combined effect of public transfers and household taxes; this ranges from values (as percentages of household disposable income) above 5.5 in Australia, Belgium, Denmark and Sweden, to values of around 2 in Japan, Poland

Table 3.17 Redistribution through Cash Transfers and Household Taxes towards People at the Bottom of the Income Ladder, Mid-2000s

	Gross public transfers paid to households			Direct taxes and social security contributions paid by households			
	A. Average ratio of household disposable income	B. Share of public transfers paid to lowest quintile	C. Transfers to lowest quintile (A*B/100)	D. Average ratio of household disposable income	E. Share of taxes paid by lowest quintile	F. Taxes from lowest quintile (D*E/100)	G Net transfers to lowest quintile (C-F)
Australia	14.3	41.5	5.9	23.4	0.8	0.2	5.8
Austria	36.6	13.9	5.1	33.4	5.4	1.8	3.3
Belgium	30.5	24.1	7.3	38.3	3.9	1.5	5.8
Canada	13.6	25.7	3.5	25.8	2.3	0.6	2.9
Czech Republic	24.3	23.0	5.6	21.6	3.5	0.8	4.8
Denmark	25.6	36.0	9.2	52.5	6.1	3.2	6.0
Finland	14.4	32.9	4.7	30.1	4.0	1.2	3.5
France	32.9	16.2	5.3	26.0	5.6	1.5	3.9
Germany	28.2	17.4	4.9	35.5	2.1	0.7	4.2
Ireland	17.7	30.8	5.4	19.4	0.9	0.2	5.3
Italy	29.2	21.6	3.7	30.2	1.8	0.6	3.1
Japan	19.7	15.9	3.1	19.7	6.0	1.2	2.0
Korea	3.6	24.9	0.9	8.0	5.8	0.5	0.4
Luxembourg	30.6	13.9	4.3	23.8	5.9	1.4	2.8
Netherlands	17.1	31.5	5.4	24.7	3.4	0.8	4.5
New Zealand	13.0	34.0	4.4	29.0	1.8	0.5	3.9
Norway	21.7	27.7	6.0	33.2	4.6	1.5	4.5
Poland	35.8	9.0	3.2	27.7	6.0	1.7	1.6
Slovak Republic	26.0	19.0	4.9	20.0	5.0	1.0	3.9
Sweden	32.7	25.9	8.5	43.2	6.5	2.8	5.7
Switzerland	16.0	29.2	4.7	36.0	12.4	4.5	0.2
United Kingdom	14.5	31.4	4.6	24.1	1.7	0.4	4.1
United States	9.4	24.8	2.3	25.6	1.6	0.4	1.9
OECD-23	22.0	24.4	5.4	28.3	4.2	1.2	4.2

Notes: Values in Columns A and D are the ratios of public transfers and household taxes, respectively, in the disposable income of the entire population; Columns B and E show the shares of public transfers and household taxes received and paid, respectively, by people of the bottom quintile of the population. Data refer to the mid-2000s for all countries. The table excludes countries where data on household taxes are not available (i.e. where available data on public transfers are expressed 'net' of taxes).

Source: OECD Income Distribution Questionnaire.

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

and the United States, and to less than 0.5 in Switzerland and Korea (Column G).

- » Third, there are large differences in the mix of cash transfers and household taxes used to redistribute income towards people at the bottom of the income scale. For example, the value of the public transfers to people in the lowest quintile (Column C) is thirty times that of the household taxes they pay (Column F) in Australia and Ireland, and more than ten times in the United Kingdom, compared with levels of only twice (or less) for Korea and Poland. Nordic countries transfer large amounts of gross benefits to low-income people but also levy a significant amount of household taxes on them; conversely, most English-speaking countries pay less generous transfers but offset this partly by levying lower household taxes on them.
- » Fourth, countries redistribute income towards people at the bottom of the income scale through different combinations of the size and progressivity of their taxes and transfers. For example, Australia and Norway pay comparable amounts of gross transfers to low-income people, with a spending effort in the former country of only two-thirds that of the latter—the difference being offset by a far greater targeting of the transfers paid (about 50 per cent more, on the measure used here). Similarly, both Korea and the United States collect a similar amount of tax from low-income households but achieve this through a low general tax level in the former country and through targeted tax credits in the latter.
- » Fifth, even though Australia spends less than the OECD average on social security benefits, the formula for distributing benefits is so progressive—and the level of taxes paid by the poor is so low—that Australia appears to redistribute more to the poorest 20 per cent of the population than any other OECD country, except Denmark (which spends about 80 per cent more than Australia).

3.4 How Generous Are Australian Welfare Payments?

As noted earlier, a common international characterisation of Australia's social security system is that it is a residual benefit system, while the discussion above has argued that net redistribution to the poor in Australia is among the highest of all OECD countries. How can these views be reconciled?

In many areas of the welfare state debate, a good deal depends on how things are measured. An initial observation is that in an earnings-related transfer system poor people get less than the average benefit (because benefits increase with higher previous earnings), while in an income-tested system poor people get more than the average benefit (because benefits fall with any additional income). So comparing average benefits across systems does not tell us who is more generous to the poor.

International comparisons of benefit entitlements commonly use OECD estimates of net replacement rates; how the disposable income of beneficiaries compares with the income after taxes of the 'average worker' (OECD 2004). As a starting point, it is important to note that because Australia and New Zealand rely on income-tested flat rate entitlements rather than earnings-related benefits, it is undoubtedly true that for higher income earners, Australian benefits are ungenerous. For example, to take the case of a 40-year-old single worker who has contributed to unemployment insurance for twenty-two years: in France, such a worker on becoming unemployed would receive between 57 per cent and 75 per cent of their gross earnings for up to thirty months, with a maximum benefit payable of nearly 65,000 Euros (about three times the average wage)⁴²; in Japan, Luxembourg, the Netherlands, Norway, Portugal and Switzerland the maximum unemployment insurance benefit payable would be higher than average earnings; in Sweden the maximum is about three-quarters of average earnings, while in other countries unemployment insurance figures of 40–50 per cent of average earnings are common maxima (OECD 2004).

When insurance benefits are exhausted, most commonly after six to twelve months (but as high as thirty months in France, thirty-six months in Norway, forty-eight months in Denmark, and sixty months in Iceland), an unemployed person may become eligible for unemployment assistance, which is similar in structure to unemployment benefits in Australia and New Zealand. In addition to Australia, New Zealand and the United Kingdom, ten OECD countries have unemployment assistance schemes (OECD 2004). These benefits are commonly flat rate and range between 20 per cent and 40 per cent of the average wage, although in Austria they can be as high as 51 per cent of the average wage. Other countries without unemployment assistance rely on general social assistance schemes.

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

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

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

Moreover, for families with children other measures of benefit generosity suggest a very different picture. Table 3.18 shows four alternative measures of benefit levels for social assistance recipients with children: benefits expressed as a percentage of the net average production worker's wage; adjusted by PPP to US dollars; expressed as a percentage of GDP per capita; and expressed as a percentage of median disposable income (from household income surveys). Given the difficulty in comparing wage levels as a result of differing levels of employer social security contributions, it can be argued that either PPP-adjusted benefit levels or benefits as a percentage of GDP per capita are likely to provide more consistent international measures. On balance, the best measure is likely to be taking benefits as a percentage of GDP per capita or as a percentage of median disposable income, given that part of the reason why PPP-adjusted measures vary across countries is that countries vary in their level of national income.

Table 3.18 shows that for lone parents with two children benefit entitlements as a per cent of the average wage in Australia are around the OECD average, and exceeded by seventeen countries. Adjusted by PPP, Australian benefits are nearly 40 per cent above the average and exceeded by six

countries. As a percentage of GDP per capita, Australian benefits for lone parents are about 30 per cent above the OECD average, and also exceeded by six countries. As a percentage of median household income, Australian social assistance benefits are the third-highest in the OECD and exceeded only by the United Kingdom and Denmark. For unemployed couples with children, benefits are slightly more generous with Australia ranked equal fifth on the GDP per capita measure and second on the median income measure.

It is important to note, however, that the fact that Australian benefits for poor families are generous compared to many other countries does not in itself mean that benefit levels are adequate, or that there is not a case for increasing them. Adequacy of benefits can only be defined by reference to the living standards that Australian benefits afford in Australia, and political and social judgments about what is an acceptable living standard for Australians. The fact that benefits for the Australian poor are higher than benefits for the Italian poor does not help anyone in Australia pay the rent or any other bills. But it does mean that it isn't valid to argue for increasing benefits in Australia because Australia spends less on welfare than Italy and many other countries.

Table 3.18 Parameters of Social Assistance Schemes, OECD Countries, 2003 to 2005

	Lone parent, two children				One-earner couple, two children			
	USD PPPs	% average wage	% GDP per capita	% of median equivalent income	USD PPPs	% average wage	% GDP per capita	% of median equivalent income
Australia	17,150	48	61	60	20,180	57	72	62
Austria	14,650	58	50	50	17,680	70	61	50
Belgium	14,140	42	51	43	14,140	42	51	37
Canada	15,850	49	52	36	16,780	51	55	33
Czech Republic	7,120	51	47	45	9,000	65	60	49
Denmark	18,810	53	64	61	21,260	60	73	52
Finland	14,730	54	56	52	17,910	65	68	54
France	13,020	54	48	44	14,330	60	53	42
Germany	15,790	47	61	54	16,850	51	65	54
Greece	400	2	2	2	400	3	2	2
Hungary	2,610	29	19	33	2,470	27	18	38
Iceland	15,850	59	56	–	21,020	78	74	–
Ireland	14,530	58	44	52	19,350	77	59	58
Italy	440	2	2	0	590	2	2	0
Japan	18,430	63	68	52	11,700	40	43	48
Korea	11,410	37	67	–	14,200	46	84	–
Luxembourg	19,120	62	39	41	24,470	80	50	45
Netherlands	16,660	52	57	48	15,960	50	55	44
New Zealand	13,570	50	62	55	14,590	53	67	36
Norway	17,190	56	48	52	15,230	52	43	51
Poland	5,350	38	49	50	7,230	52	67	40
Portugal	5,830	47	32	32	8,280	67	45	40
Slovak Republic	5,410	65	44	–	7,400	90	60	–
Spain	7,200	34	32	27	7,900	37	35	23
Sweden	12,580	51	46	49	15,200	62	56	51
Switzerland	19,960	59	66	45	21,959	65	72	42
United Kingdom	17,940	58	64	70	20,500	66	73	68
United States	9,780	30	27	21	11,800	37	33	22
OECD-28	12,340	47	47	41	13,871	54	53	40

Notes: Results relate to the situation of a person who receives no unemployment insurance benefits but is entitled to income-related benefits, such as social assistance and housing benefits, and receives family benefits. The values of housing benefits assume that rent before benefits is 20 per cent of average earnings. Children are aged 4 and 6 and neither child-care benefits nor child-care costs are considered. Median equivalent incomes are projected to 2005 values using changes in the Consumer Price Index. –: Data not available.

Source: Calculations by author.

3.5 Are Effective Tax Rates Higher in Australia than Elsewhere?

A concern expressed in many OECD countries including Australia relates to the high effective marginal tax rates (EMTRs) facing low-paid workers as they make the transition from receipt of benefits into paid work, or as potential second earners enter or re-enter the paid labour market. Given that Australia has the most targeted transfer system in the OECD, it would seem logical to expect that high effective tax rates will be more prevalent in Australia than in most other countries.

However, while the Australian transfer system is the most targeted in the OECD this does not necessarily mean that poverty traps will be more severe in Australia. Are Australian benefits subject to stringent income and assets tests? This is certainly true if one makes a comparison with social insurance benefits, which are not income or asset tested. However, social assistance schemes in most other countries are considerably more stringent than in Australia or New Zealand. In virtually all other OECD countries, the benefit withdrawal rate in social assistance schemes is 100 per cent (apart from Canada, and for Food Stamps in the United States); only thirteen OECD countries have income disregards or free areas in assistance schemes, and in most of these this is only for earnings and in some cases only for limited periods (OECD 2004).

Assets tests are also generally much more generous in Australia than in other OECD countries, apart from New Zealand. Australia also has a centralised benefit system with legislated rights of appeal, while many other countries have decentralised systems with significant discretionary elements. In addition, in countries such as Austria, France, Luxembourg, Germany and Switzerland, social assistance benefits are claimable from relatives or there may be obligations to repay benefits either after employment is found or on the death of the recipient (Eardley et al. 1996).

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

It can also be noted that social insurance benefits do not necessarily lead to lower effective tax rates than assistance benefits, even though insurance benefits are not income tested. This is simply because most insurance benefits are targeted through eligibility criteria rather than through explicit income tests. Unemployed people receive social insurance benefits only while they have entitlement to assistance, so that a person who finds a job at the average wage will simply not be entitled to benefits under a social insurance system because they no longer qualify as unemployed. In fact, under the insurance systems in most OECD European countries individuals can lose their

entitlements once they take up part-time work, so that effective tax rates are potentially just as high as in Australia. The exception to this general rule is the spouse of an unemployed worker. While Australia partially individualises its benefit system for couples, the income test applies jointly to both partners. In contrast, under social insurance systems the entitlements of an unemployed worker are not affected by the earnings of their spouse or vice versa, thus encouraging participation by partners.

It is certainly true in nearly all OECD countries, and also in Australia, that effective tax rates on the low paid can be higher than on average earners or the high paid, primarily through the interaction of direct taxes with the withdrawal of benefits. Figure 3.9 shows the pattern of effective marginal tax rates for a lone parent with two children in Australia under the 2005 tax and benefit system. It is apparent that effective marginal tax rates are around 60 per cent when income is between 20 per cent and 60 per cent of the average wage, and can exceed 80 per cent when family income is 60–70 per cent of average earnings, which is far higher than the top marginal income tax rate. However, it is also apparent that effective marginal tax rates can be significantly lower than this for families at a lower earnings level.

Figure 3.9 also shows the corresponding patterns in Denmark, which is typical of a number of European countries, both for someone receiving unemployment insurance and for a lone parent ineligible for insurance and receiving social assistance. In the Danish case, EMTRs for an assistance recipient reach 100 per cent over quite a wide range of income up to around half the average wage. For the lone parent eligible for unemployment insurance effective tax rates are around 80 per cent from zero to nearly 90 per cent of the average wage, lower than for a Danish assistance recipient but higher than for an Australian assistance recipient except for those with 60–70 per cent of the average wage.

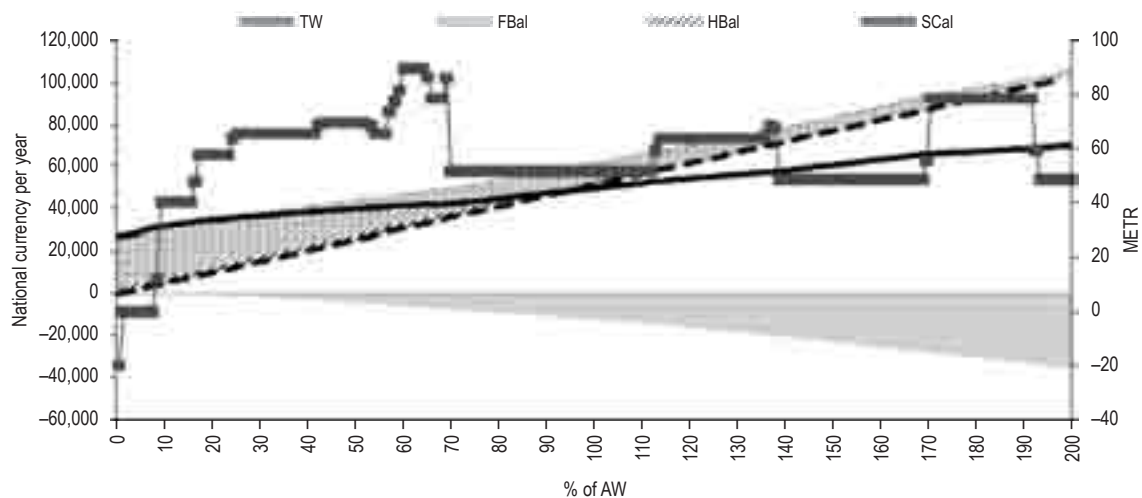
In addition, the effective marginal tax rate for a family making marginal changes in hours or earnings at 60–70 per cent of average earnings should not be a barrier for someone moving from joblessness to part-time or low-paid full-time work. Here the relevant concept is the average effective tax rate (AETRs), which is simply the average of all the EMTRs over a wider range of income, for example, from zero earnings to one-third or two-thirds of the average wage.

Figure 3.10 shows calculations of AETRs for lone parents in moving from joblessness into part-time work at one-third of the average wage. This shows that effective tax rates for Australian lone parents on moving into part-time work are at around 40 per cent and are among the lowest in the OECD. Only Italy, Greece and the United States have lower AETRs for these families, for the reason that they provide much lower levels of benefits for jobless families (in the case of Italy, none), so that the withdrawal of this assistance does not noticeably impact on disposable income. AETRs exceed 80 per cent in ten OECD countries and approach 100 per cent in five countries.

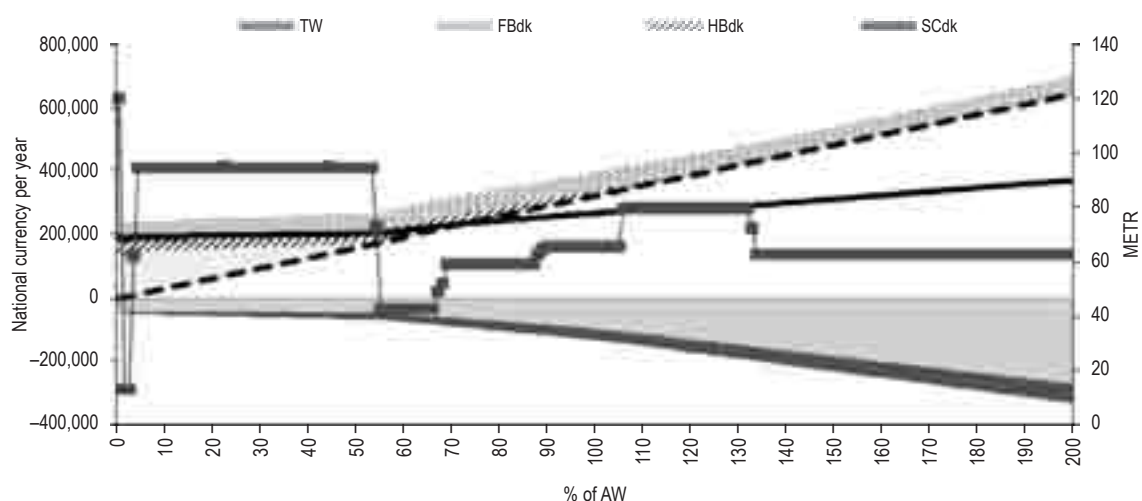
Figure 3.11 shows the corresponding calculation for a lone parent with two children in moving from joblessness to earning two-thirds of the average wage, likely to be a full-time but low-paid job. AETRs in Australia rise to over 50 per cent because effective tax rates are higher in Australia

Figure 3.9 Effective Marginal Tax Rate Schedule, Lone Parent Families with Two Children

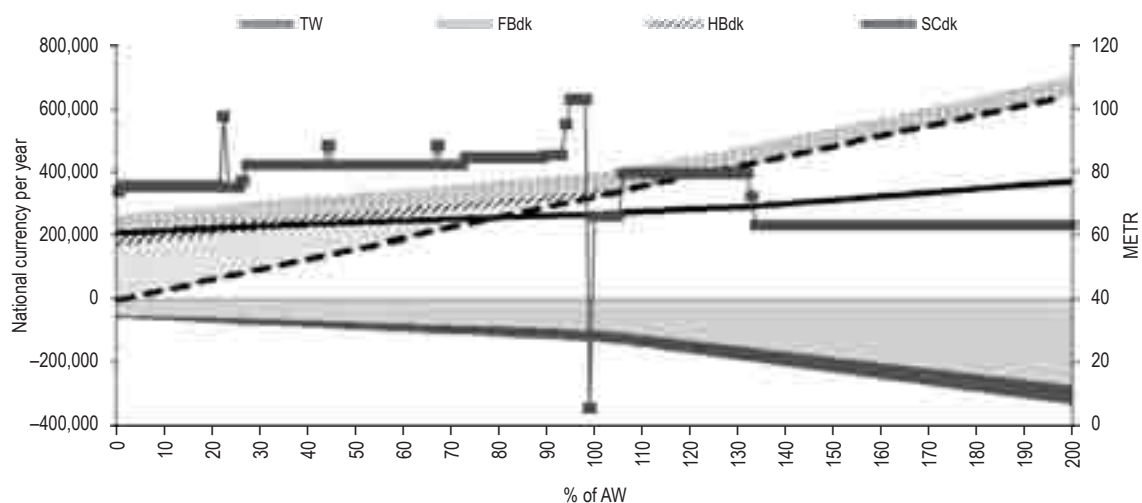
Panel A: Australia, 2005, lone parent with two children, not eligible for unemployment insurance benefits



Panel B: Denmark, 2005, lone parent with two children, not eligible for unemployment insurance benefits



Panel C: Denmark, 2005, lone parent with two children, eligible for unemployment insurance benefits



Notes: GROSS: Gross employment income. NET: Net Income. IT: Income Tax (net of any tax credits). SC: employee's Social security Contributions. SA: Social Assistance or minimum income benefits. UB: Unemployment Benefits. HB: Housing-related cash Benefits. FB: Family Benefits. IW: In-Work or employment-conditional benefits. PoAW: Per cent of AW. AW: The Average Worker wage. METR: Marginal Effective Tax Rate, i.e. the fraction of any additional earnings that is taxed away by the combined effect of taxes and benefit withdrawals. $METR = 1 - (\text{change in NET} / \text{change in GROSS})$. METRs are computed for an earnings change of 1 per cent of AW.

between one-third and two-thirds of the average wage than they are below one-third of average earnings. While Australia rises up the OECD rankings, it does so only slightly—although it can be noted that AETRs fall for some other countries.

Figure 3.12 shows the impact of child-care costs on average effective tax rates for a lone parent on moving into a low-paid full-time job. Child-care costs do reduce the returns to paid work in Australia⁴³ but the impact is relatively small, and even after adding in net child-care costs, AETRs in Australia remain towards the lower end of the range of OECD countries. In contrast, they dramatically add to AETRs in Ireland.

In summary, it should be made clear, therefore, that while high effective tax rates and high child-care costs can be a barrier to jobless families taking up paid work, differences in effective tax rates cannot be used to explain variations in family joblessness across countries. Australia and other countries such as the United Kingdom and New Zealand with very high levels of family joblessness have relatively low effective tax rates on the transition into part-time work, while others such as Denmark, which has very high effective tax rates, have very low joblessness. Moreover, contrary to what might be expected, effective tax rates in Australia tend to be lower than in many other countries, despite Australia's reliance on income testing.

Figure 3.10 Average Effective Tax Rates for a Lone Parent with Two Children in Moving from Joblessness to 33 Per Cent of the Average Wage, 2005

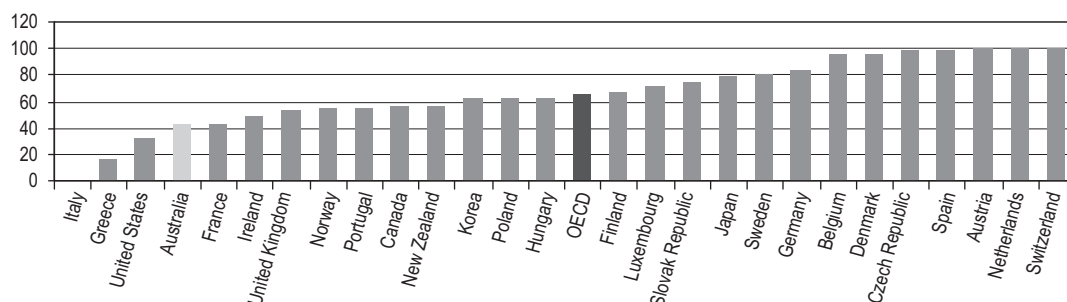


Figure 3.11 Average Effective Tax Rates for a Lone Parent with Two Children in Moving from Joblessness to 66 Per Cent of the Average Wage, 2005

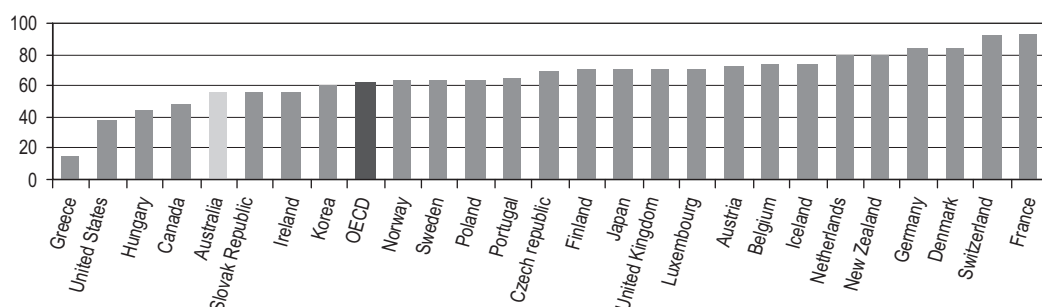
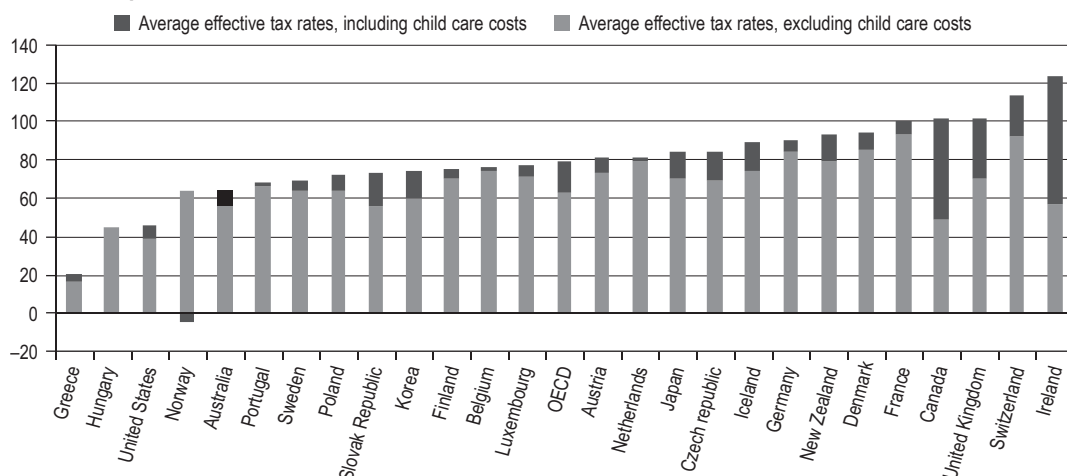


Figure 3.12 The Impact of Child-Care Costs on Work Incentives, OECD Countries, 2004



43 Fees (before child-care assistance) in Australia are roughly 40 per cent higher than the OECD average, but child-care assistance reduces costs significantly, particularly for low-income parents. In 2004, net fees for a high income couple were about 14 per cent of net family income (2 percentage points above average), but for a low-income lone parent they were 7 per cent of net income (5 percentage points below average), comparable to France, Austria and Denmark.

3.6 Discussion and Conclusion

This chapter has presented a wide range of statistical evidence on the design features and apparent outcomes of the Australian transfer system and those in other rich OECD countries. Looking at the OECD overall, a number of broad conclusions can be reached. Indicators of the redistributive impacts of welfare states based on the 'standard approach' show that the tax and benefit systems of all OECD countries reduce income inequality, with the impact being greatest in the Nordic countries and least in the United States and Korea. However, in a number of countries, a significant part of this redistribution results from the 're-ranking' of people where, for example, middle-income households are treated as if they fall into deep poverty upon retirement, with their income gap then ameliorated by generous, earnings-related public pensions. After accounting for re-ranking, 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, for example. The redistributive effect of the welfare state is also generally larger for public cash benefits than for household taxes—except in the United States, which is the only OECD country that achieves more redistribution through the tax system than through the transfer system, and also achieves more redistribution through the tax system than any other country.

More specifically, public spending on cash benefits in Australia is lower than in many other countries and around 70 per cent of the OECD average, but Australia relies on income testing more than anywhere else in the OECD and targets a higher share of its transfers to the poor than elsewhere. A range of indicators suggest that this approach has been extremely effective. Overall, Australia has had the most progressive benefit system in the OECD for at least the past twenty years. Despite changes that may be seen as extending middle class welfare, the progressivity of the overall system has increased over time and spending has also increased with the result that the Australian system is likely to have even further increased its effectiveness in reducing poverty and inequality.

Again as a result of these design features, Australia has less 'middle class welfare' than any other OECD country, lower 'churning' of benefits than all other countries except Korea (which has only a limited welfare state in comparison with the majority of OECD countries) and lower churning even than Korea when this is expressed as the potential reduction in taxes that could be achieved. Australia also has the most 'efficient' system of transfers in terms of inequality reduction of any OECD country; for each dollar of spending on transfers Australia reduces income inequality by about 50 per cent more than the United States, Denmark or Norway, twice as much as Korea, and roughly two and a half times as much as Japan or Italy, and three times as much as France. The OECD data sources also find that Australia has one of the most progressive systems of direct taxes of any OECD country, and that the tax system like the transfer system is one of the most 'efficient' in reducing inequality of any rich country.

Due to the design features of targeted spending and progressive taxes, the 'efficiency' of Australian arrangements

boosts effectiveness. Using the preferred measure of redistribution discussed earlier, it can be argued that Australia reduces income inequality by about as much as countries like Denmark and Sweden, usually seen as the epitome of redistributive welfare states. Moreover, even though Australia spends less than the OECD average on social security benefits, the formula for distributing benefits is so progressive—and the level of taxes paid by the poor is so low—that Australia appears to redistribute more in absolute terms to the poorest 20 per cent of the population than any other OECD country, except Denmark (whose transfer spending is about 70 per cent more than Australia's).

And even though Australia has the most progressive transfer system in the OECD—and probably the world—effective marginal tax rates on low-income households are among the lowest in the OECD; the only countries with lower effective tax rates are those that provide much less generous benefits for the poor. As an aside, in other work based on the same data sources, I found that the combination of Australia's relatively high minimum wages and targeted family benefits also reduces child poverty among working families by more than any other country and therefore Australia has the lowest level of 'in-work poverty' among families with children of any OECD country (Whiteford 2009). We have a system which is both generous to low-income families and in which it pays to work.

If this summing-up sounds too good to be true then perhaps that is the case. Or it may be that debates about the architecture of the transfer system are not pointing us towards the more fundamental issues that need to be addressed. Anyone who knows Australia well also knows that there are very significant problems of disadvantage, particularly among the indigenous population, the homeless, and jobless families, for example.

Do international comparisons help us address these problems? As mentioned earlier, no poor person in Australia is actually made better off because our benefits to the poor are more generous than those paid in Italy; but nor are they worse off because Italy spends twice as much on transfers than Australia. The fact that we have less churning than nearly all other countries, and less middle class welfare than all other OECD countries does not mean that we cannot or should not reduce churning or middle class welfare further if we think this is desirable. We may have the most target-efficient transfer system of any OECD country, but that does not mean that it couldn't be more target efficient and, more importantly, more effective.

International comparisons are helpful for putting both the achievements of the tax-transfer system and its limitations into perspective. For example, the Australian pension system has been described as 'radically redistributive' by an American observer (Aaron 1992). In contrast, Warby and Nahan (1998) describe the Australian transfer system as 'a badly arranged, inefficient, expensive insurance market where risks and liabilities are very poorly connected'. Alternatively, Wicks argues that 'the welfare system is highly redistributive, but it is wrong to assume that this distribution is from wealthy to poor households. A substantial amount of welfare is distributed to middle and high income households' (2005, p. 9). While both the

second and the third of these characterisations can be justified in different ways, it seems fair to argue that the first observation by Aaron (1992) is closer to the truth.

Overall, I would draw the general conclusion that 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.

International comparisons also involve many conceptual and measurement challenges, and making sure that we are really comparing like with like is difficult to achieve. Nevertheless, comparisons provide the opportunity to assess alternative tax and transfers designs with real world examples; while they help us identify our strengths, they also help us identify our weaknesses.

Despite the impressive design features of our tax and transfer systems, disposable income inequality in Australia was only just below the OECD average in 2005, so that if Australia is one of the most effective countries in the world at reducing inequality, then it would appear to follow that income inequality before taxes and transfers is higher than in the countries with better inequality outcomes. This implies that if Australia wants to reduce inequality even more it should either increase its impressively high level of progressivity, or tax and spend more while at least maintaining effective progressivity, or identify the factors associated with the relatively high level of market income inequality and attempt to address these problems more directly.

The recent OECD report *Growing Unequal* (2008) helps in identifying some of the factors that are relevant. Some factors can be eliminated: Australia has one of the least unequal distributions of capital incomes among people of working age of any OECD country, with only three countries having lower inequality of capital income; the concentration coefficient for capital income is about 60 per cent of that in Sweden, for example, and about half the level of the United States or Norway. This, of course, does not imply that a more equal distribution of capital incomes would not help reduce inequality—simply that its current distribution is not a candidate for explaining higher market income inequality in Australia.

Australia's challenges appear more strongly related to household structure and the distribution of labour market opportunities. Australia was only one of four OECD countries where market and disposable income inequality fell in the period to 2005; changes in population structure due to the combined effect of changes in the age and household structure of the population contributed to higher inequality in most countries, but the effect was strongest in Australia. With a constant demographic structure, the fall in inequality would have been about 20 per cent higher than it actually was, and Australia would have enjoyed the second-largest fall in income inequality of any OECD country.

While Australia has a relatively low share of retirement-age households the relative incomes of this group are among the lowest in the OECD, and the relative poverty rates among this group are the fourth highest in the OECD. While it is clear that there is a significant degree of disadvantage experienced by those who are completely or

mainly reliant on Age Pensions (particularly those in private rental housing), these international comparisons are potentially misleading because they do not take full account of Australia's high level of housing and financial wealth among the older population. For example, Bradbury (2008) finds that own-home ownership wealth is a much greater proportion of disposable income in Australia than in all the North American and European countries he analyses. Home ownership in retirement increases the total consumption of the Australian elderly to the point where their drop in total consumption after retirement is close to the average (despite their greater drop in income). In 2003–04, Australians over 65 years of age had housing wealth in owner-occupied housing that was equivalent to more than seven years worth of their average household disposable income. This was more than twice the average for the other OECD countries for which data are available. Older Australians also had average levels of financial assets that were equivalent to roughly eight years worth of their disposable incomes, a level at least 50 per cent higher than the average for other countries. Yates and Bradbury (2009) find that disposable income poverty rates for older households in Australia are the highest of seven OECD countries, but when account is taken of housing costs they are the third lowest and considerably below Sweden, for example. Poverty rates for non-home owners remain high, however.

Inequality among full-time male and female wage earners is around average for the OECD; however, including part-time workers significantly increases earnings inequality, but this is true for most OECD countries, so Australia remains around the average. Moving from individual to household earnings has a more significant effect. The distribution of earnings of spouses of household heads in Australia is one of the most unequal in the OECD and the earnings of other household members are also highly unequal (individuals are ranked by household disposable income so this means that higher income primary earners are more likely to have high earner spouses). Thus, while the Gini coefficient for all full-time workers is around 0.28, for full and part-time workers it is around 0.35, and for household earnings it is around 0.40.

Including working-age households where no-one is in paid employment significantly raises inequality. As shown in Table 3.19, while Australia has the eighth-lowest non-employment rate for working-age individuals, it has the fifth-highest joblessness rate for households, and for households with children it has the fourth-highest joblessness rate in the OECD (Whiteford 2009). Inequality of household earnings including households with no earnings is the second highest in the OECD with the Gini coefficient at around 0.58. Overall, this suggests that if we wish to reduce inequality more effectively then it is unequal access to paid work that needs to be addressed.

In this context, it is clear from earlier discussion that while high effective marginal tax rates could well be an important problem for some low earners they are unlikely to explain Australia's relatively high rate of family joblessness. A more rational pattern of EMTRs may well benefit people moving between part-time and full-time work and also benefit second earners in families where

Table 3.19 Individual, Household and Family Joblessness, OECD Countries, 2005

	Non-employment rate for working age population	Share of working age population living in jobless households	Share of households with children jobless	Ratio of household joblessness to individual joblessness	Ratio of family joblessness to individual joblessness
Australia	28.4	14.2	11.9	0.50	0.42
Austria	31.4	11.0	5.3	0.35	0.17
Belgium	39.0	18.6	12.0	0.48	0.31
Canada	27.5	6.2	3.9	0.23	0.14
Czech Republic	35.2	10.1	7.3	0.29	0.21
Denmark	24.5	9.2	4.7	0.38	0.19
Finland	32.0	7.3	3.9	0.23	0.12
France	37.7	11.6	4.4	0.31	0.12
Germany	34.5	19.4	16.3	0.56	0.47
Greece	39.7	6.5	1.4	0.16	0.04
Hungary	43.1	19.1	14.7	0.44	0.34
Iceland	–	2.1	1.7	–	–
Ireland	32.9	11.7	11.4	0.36	0.35
Italy	42.5	9.6	3.3	0.23	0.08
Japan	30.7	5.1	1.5	0.17	0.05
Korea	36.3	5.5	3.9	0.15	0.11
Luxembourg	36.4	7.1	2.3	0.20	0.06
Mexico	40.4	3.8	3.2	0.09	0.08
Netherlands	28.9	9.1	5.8	0.31	0.20
New Zealand	25.4	9.3	9.6	0.37	0.38
Norway	24.8	13.1	7.5	0.53	0.30
Poland	47.0	14.0	8.3	0.30	0.18
Portugal	32.5	5.9	3.9	0.18	0.12
Slovak Republic	42.3	10.6	6.4	0.25	0.15
Spain	35.7	5.8	3.5	0.16	0.10
Sweden	26.1	6.2	3.6	0.24	0.14
Switzerland	22.8	5.9	2.8	0.26	0.12
Turkey	54.1	10.4	7.5	0.19	0.14
United Kingdom	27.4	16.3	14.9	0.59	0.54
United States	28.5	6.3	4.5	0.22	0.16
OECD	34.1	9.7	6.4	0.28	0.19

Note: –: Data not available.

Source: OECD, Growing Unequal (2008) and OECD Income Distribution Questionnaire.

there is already one adult in paid employment. EMTRs also appear to be more of a barrier for people in public rental housing than in other tenures.

The problems of the most disadvantaged and long-term jobless appear to include very low levels of educational attainment (around 60 per cent having Year 10 qualifications or below), lack of access to reliable transport, relatively unsafe neighbourhoods for families with children, and complex personal problems including poor health and disabilities among adults and children. While it is possible that poorly designed tax and transfer systems might exacerbate these problems, it is difficult to see that transfer reform can resolve them. Instead, what seems more promising for these groups is a more effective mix of services that support participation generally (e.g. better child-care) plus targeted employment support programs and activation policies.

Despite the impressive design features of our tax and transfer systems, the results summarised above concentrate on the apparent outcomes of the publicly funded and delivered part of the Australian system of social protection. At the beginning of this chapter, it was argued that it is necessary to use a comprehensive definition of social protection mechanisms in order to assess the relative size and performance of Australian transfer arrangements. To

do so, it is necessary to take account of the interactions between transfers and taxes as well as other forms of social protection provided through government mandates or voluntarily.

It was also pointed out that the two major objectives of the welfare state are to redistribute across the life-cycle and to redistribute between rich and poor. Australia like all other OECD countries pursues both objectives, but the public system strongly emphasises redistribution between rich and poor—more strongly than any other OECD country. In a sense, Australia has separated these two objectives into different instruments, playing ‘Robin Hood’ mainly but not entirely through the government social security system and redistributing across the life-cycle through a range of mechanisms, including mandatory superannuation and support for home ownership, which are largely achieved through non-state mechanisms, although significantly supported by tax expenditures.

In contrast, the social security systems of other OECD countries tend to try to achieve both forms of redistribution within the one system, which inevitably makes these systems look less efficient, involves more churning and produces more middle class welfare. But just as the Australian system must necessarily look more administratively efficient than social insurance systems, social insurance systems will tend

to look more effective at reducing inequality for the reasons discussed earlier.

Do differences in public and private provision matter? This question is at the heart of other major debates about the effects of welfare state provisions. On the one side, there are arguments that high levels of welfare state spending (and taxing to finance this spending) create inefficiencies that reduce work effort and saving. On the other side, there are arguments that high levels of welfare state spending are associated with lower levels of inequality and poverty, and that even though this may reduce incentives to work and save, it may well be a price worth paying for these better distributional outcomes.

However, the discussion earlier in this chapter shows that the conventional measures of welfare state effort are seriously misleading; total net public and private social expenditure shows much less dispersion than gross public spending, tax effects or private social spending. If welfare state effort is mismeasured, is it possible that welfare state effects and outcomes are also mismeasured? Do variations in the mix of public and private provision matter as much for incentives and equity as they do for measured levels of spending?

The literature on the incentive effects of welfare states is vast but one view is that of Schuknecht and Tanzi (2005, p. 9), who argue that:

... high levels of public spending create inefficiencies on the tax side—because they require higher tax rates—and on the expenditure side—because they require large bureaucracies, and because, from the individual citizen's point of view, government services often have a zero (or at least a very low) price thus stimulating greater demand for them. Finally, high public spending may lead to macroeconomic difficulties when it is partly financed by fiscal deficits.

In contrast, Lindert (2005, p. 1) argues that:

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

It is sometimes argued that private provisions can have better implications for incentives to work and save than public provisions (Disney 2004), leading to government interest in reforming public provisions to make them more like private provisions, most notably in regard to pensions, but also sickness coverage. However, Disney (2004) also points out that contributions to public pension programs differ from other taxes levied on households to the extent that participants perceive contributions as giving them a claim to future pension benefits:

To the extent that pension contributions are perceived as giving individuals rights to future pensions, the behavioural reaction of program participants to

contributions will differ from their reactions to other taxes. In fact, they might regard pension contributions as providing an opportunity for retirement saving, in which case contributions should not be deducted from households' earnings, and should not be included in the tax wedge. An issue for program design therefore arises: if pension programs can be designed explicitly to look like retirement saving programs, the potentially adverse impact of higher pension contributions on employment might be alleviated.

Disney (2004) notes that the diversity of program design can be illustrated by comparing two types of program. At one extreme, the Swedish public pension reform in 1998 and the Italian pension reform in 1995 tried to make their public pension programs look more like a private retirement saving system by linking individual pension entitlements very closely and explicitly to actual contributions paid. At the other extreme, Australian public pensions are income tested and financed out of general taxation. Disney (2004) argues that these design features, as well as the overall costs of the program, matter for incentives. Disney's (2004) results reveal robust evidence that when public pension program contributions are broken down into a tax component and a savings component, the tax component of the payroll contribution reduces economic activity rates among women while a higher retirement saving component has the opposite effect. He finds little evidence that average tax rates, however constructed, have any adverse impact on the economic activity rates of men.

These arguments can be put another way: the reason why some high-spending welfare states have less adverse implications for incentives than expected is that they are structured like private provision. There is a stronger association between what people put into the welfare state and what they get out of the welfare state than in some low-spending but more progressive countries like Australia. In effect, high-spending welfare states incorporate private spending design features within their public systems. Lower spending welfare states tend to separate public and private provision. Disney's (2004) results can be seen as confirming Lindert's (2005) arguments: *the design of welfare states matters for outcomes*.

Finally, it is worth recalling the comments of the Secretary of the Treasury, Ken Henry (2009), at the recent ACOSS National Conference: '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'. This chapter has shown that the architecture of Australia's tax and transfer system differs very significantly from those in other rich countries. Australia's distinctive tax-transfer system suggests that we aspire to achieve a very high level of egalitarianism. We wish to assist those in need, but we also want to do this in as efficient and effective a way as possible. To achieve these goals it is important not only to have a clear understanding of the architecture and design of our transfer system, but also to have a clear sense of the social outcomes we are aiming for.

References

- Aaron, H 1992, 'The economics and politics of pensions: evaluating the choices', in *Private pensions and public policy*, OECD, Paris.
- Åberg, R 1989, 'Distributive mechanisms of the welfare state—a formal analysis and an empirical application', *European Sociological Review*, no. 5.
- Adema, W 2001, *Net social expenditure*, Labour market and social policy occasional paper, no. 52, OECD, Paris.
- Einerhand, M, Eklind, B, Lotz, J & Pearson, M 1996, *Net public social expenditure*, Labour market and social policy occasional paper, no. 19, OECD, Paris.
- & Ladaïque, M 2005, *Net social expenditure*, Labour market and social policy occasional paper, OECD, Paris.
- & Whiteford, P forthcoming, 'Public and private social welfare', in *Oxford handbook of comparative social policy*, ch. 8, Oxford University Press.
- Ankrom, J 1993, 'An analysis of horizontal and vertical equity in Sweden, the US and the UK', *The Scandinavian Journal of Economics*, vol. 95, no. 1, March.
- Arjona, R, Ladaïque, M & Pearson, M 2002, 'Social protection and growth', *OECD Economic Studies*, no. 35, 2/2002, pp. 7–45.
- Atkinson, AB 1991, 'Social insurance; the fifteenth annual lecture of the Geneva Association', *The GENEVA Papers on Risk and Insurance – Theory*, vol. 16, no. 2, December.
- Australian Treasury 2008, *Architecture of Australia's tax and transfer system*, Department of the Treasury, Canberra.
- Barr, N 1992, 'Economic theory and the welfare state: a survey and reinterpretation', *Journal of Economic Literature*, vol. 30, June.
- 1999, 'Fundamentals of social security analysis', *Australian Social Policy*, 1999/1, pp. 7–29.
- 2001, *The welfare state as piggy bank: information, risk, uncertainty, and the role of the state*, Oxford University Press, Oxford.
- Beckerman, W 1979, 'The impact of income maintenance payments on poverty in Britain—1975', *Economic Journal*, June.
- Bradbury, B 2008, *Housing wealth as retirement saving: does the Australian model lead to over-consumption of housing?* Luxembourg wealth study working paper series, no. 7.
- Bremner, K 2005, 'Net tax thresholds for Australian families', *Economic Roundup*, winter, Department of the Treasury, Canberra.
- Castles, FG 1992, 'On sickness days and social policy', *Australian and New Zealand Journal of Sociology*, vol. 28, pp. 29–44.
- Dang, T-T, Immervoll, H, Mantovani, D, Orsini, K & Sutherland, H 2006, *An age perspective on economic well-being and social protection in nine OECD countries*, OECD social, employment and migration working paper, no. 34, OECD, Paris.
- Disney, R 2004, 'Are contributions to public pension programs a tax on employment?', *Economic Policy*, July.
- Eardley, T, Bradshaw, J, Ditch, J, Gough, I & Whiteford, P 1996, *Social assistance schemes in the OECD countries: synthesis report, 1996*, Department of Social Security research report, no. 46, HMSO, London.
- Esping-Andersen, G 1990, *The three worlds of welfare capitalism*, Polity Press, Cambridge.
- Falkingham, J & Harding, A 1996, *Poverty alleviation versus social insurance: a comparison of lifetime redistribution*, NATSEM discussion paper, no. 12, NATSEM, University of Canberra.
- Förster, M & Mira D'Ercole, M 2005, *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.
- Geanakoplos, J, Mitchell, OS & Zeldes, SP 2000, *Social security money's worth*, NBER working paper, no. 6722, available at <<http://cowles.econ.yale.edu/P/cd/d11b/d1193.pdf>>.
- Gruen, FH 1982, 'The welfare expenditure debate: economic myths of the left and the right', *Economic Record*, vol. 58, no. 162, September, pp. 207–23.
- Henry, K 2009, *How much inequity should we allow?*, speech to the Australian Council of Social Service, national conference, 3 April, Sydney.
- Howard, C 2003, 'Is the American welfare state unusually small?', *PSOnline*, July, pp. 411–16, available at <<http://www.apsanet.org>>.
- Ingles, D 1977, 'International comparisons of social security expenditure', *Social Security Quarterly*, vol. 5, no. 1, winter–spring, pp. 1–6.
- Korpi, W & Palme, J 1998, 'The paradox of redistribution and the strategy of equality: welfare state institutions, inequality and poverty in the Western countries', *American Sociological Review*, vol. 63, no. 5.
- Layard, R 1977, 'On measuring the redistribution of lifetime income', in MS Feldstein & RP Inman (eds), *The economics of public services*, Macmillan, London.
- Leimer, DR 1995, *A guide to social security money's worth issues*, ORS working paper, no. 67, Social Security Administration, Washington DC.
- Lindert, PH 2004, *Growing public: social spending and economic growth since the eighteenth century*, Cambridge University Press, Cambridge.
- 2005, *Growing public: is the welfare state mortal or exportable?*, American University of Paris working paper, no. 25, Paris.
- Mann, K 2008, 'Remembering and rethinking the social divisions of welfare: 50 years on', *Journal of Social Policy*, vol. 38, no. 1, pp. 1–18.
- Mitchell, D 1991, *Income transfers in ten welfare states*, Aldershot, Avebury.
- O'Higgins, M, Schmaus, G & Stephenson, G 1990, 'Income distribution and redistribution: a microdata analysis for seven countries', in T Smeeding, M O'Higgins & L Rainwater (eds), *Poverty, inequality, and income distribution in comparative perspective*, Harvester Wheatsheaf, Hemel Hempstead.
- Organisation for Economic Co-operation and Development (OECD) 1976, *Public expenditure on income maintenance programs*, OECD, Paris.
- 1981, *The welfare state in crisis*, OECD, Paris.
- 1985, *Social expenditure 1960–1990: problems of growth and control*, OECD, Paris.
- 1996, *Social expenditure statistics of OECD member countries, provisional version*, Labour market and social policy occasional paper, no. 17, OECD, Paris.
- 1998, *Income distribution and poverty in selected OECD countries*, Economics Department working paper, no. 189, OECD, Paris.
- 2003, *Employment Outlook*, June, OECD, Paris.
- 2004, *Benefits and wages: OECD indicators*, OECD, Paris.
- 2007a, *Reconciling earning and caring: social policies for working families*, OECD, Paris.
- 2007b, *Revenue statistics, 1965–2006*, OECD, Paris.
- 2008, *Growing unequal: income distribution and poverty in OECD countries*, OECD, Paris.
- Palme, J 1990, *Pension rights in welfare capitalism: the development of old-age pensions in 18 OECD countries 1930–1985*, Swedish Institute for Social Research, Stockholm.

- Pederson, AW 1994, *The welfare state: still no answer to the big questions?* LIS working paper, CEPS/INSTEAD, Luxembourg.
- Piggott, J 1987, 'Statistical incidence studies: an economic perspective', in P Saunders (ed.), *Redistribution and the welfare state: estimating the effects of government benefits and taxes on household income, proceedings of a workshop held at the University of New South Wales, 13 May 1987*, reports and proceedings, no. 67, Social Welfare Research Centre, University of New South Wales.
- Podger, AS, Raymond, JE & Jackson, WS 1980, *The relationship between the Australian social security system and personal income taxation systems—a practical examination*, research paper, no. 9, Policy Review Branch, Development Division, Department of Social Security, Canberra.
- Reynolds, M & Smolensky, E 1977, *Public expenditures, taxes and the redistribution of income: the USA, 1950, 1961, 1970*, Academic Press, New York.
- Ringen, S 1987, *The possibility of politics*, Clarendon Press, Oxford.
- Rose, H 1981, 'Rereading Titmuss: the sexual division of welfare', *Journal of Social Policy*, vol. 10, no. 4, pp. 477–502.
- Schuknecht, L & Tanzi, V 2005, *Reforming public expenditure in industrialised countries: are there trade-offs?* working paper, no. 435, February, European Central Bank.
- Schut, JM, Vrooman, JC & de Beer, PT 2001, *On worlds of welfare*, Social and Cultural Planning Office of the Netherlands, The Hague.
- Siminski, P, Saunders, P, Waseem, S & Bradbury, B 2003, *Assessing the quality and inter-temporal comparability of ABS household income distribution survey data*, discussion paper, no. 123, April, SPRC, University of New South Wales.
- Sinfield, A 1978, 'Analyses in the social division of welfare', *Journal of Social Policy*, vol. 7, no. 3, April.
- SNA 1993, *System of national accounts 1993*, CEC-EUROSTAT, IMF, OECD, UN and the World Bank, Brussels/Luxembourg, New York, Paris, Washington DC.
- Ståhlberg, A-C 1985, *On misleading income comparisons between societies with social insurance sectors of different sizes*, discussion paper, no. 18/1985, Swedish Institute for Social Research, Stockholm.
- 2007, 'Redistribution across the life course in social protection systems', in *Modernising social policy for the new life course*, OECD, Paris.
- Thomson, D 1989, 'The welfare state and generation conflict: winners and losers', in P Johnson, C Conrad & D Thomson (eds), *Workers versus pensioners: intergenerational justice in an ageing world*, Manchester University Press, Manchester, New York.
- Titmuss, R 1955, 'The social division of welfare', in *Essays on the welfare state*, Allen and Unwin.
- Varley, R 1986, *The government household transfer database, 1960–1984*, Department of Economics and Statistics, working paper, no. 36, OECD, Paris.
- Vroman, W & Brusentsev, V 2005, *Unemployment compensation throughout the world: a comparative analysis*, WE Upjohn Institute, Kalamazoo.
- Warby, M & Nahan, M 1998, *From workfare state to transfer state: where we were and why we changed*, background for Institute of Public Affairs, vol. 10, no. 3, Melbourne.
- Warren, N 2008, *A review of studies on the distributional impact of consumption taxes in OECD countries*, OECD social, employment and migration working paper, OECD, Paris.
- Werding, M 2003, 'After another decade of reform: do pension systems in Europe converge?', *CESifo DICE Report*, vol. 1/2003.
- Whiteford, P 1997, 'Targeting welfare: a comment', *Economic Record*, vol. 73, no. 220, March, pp. 45–50.
- 1998, 'Is Australia particularly unequal?', in P Smyth & B Cass (eds), *Contesting the Australian way: states, markets and civil society*, Cambridge University Press, Melbourne.
- 2006, 'The welfare expenditure debate: economic myths of the left and the right revisited', *The Economic and Labour Relations Review*, vol. 17, no. 1, September, pp. 33–78.
- Millar, J & Mendelson, M 2003, *Timing it right?: tax credits and how to respond to income changes*, Joseph Rowntree Foundation, London.
- Whitehouse, E 2006, 'Pension challenges and pension reforms in OECD countries', *Oxford Review of Economic Policy*, vol. 22, no. 1, spring, pp. 78–94.
- Williamson, JB, Watts-Roy, DM & Kingson, ER (eds) 1999, *The generational equity debate*, Columbia University Press, New York.
- Yates, J & Bradbury, B 2009, *Home ownership as a (crumbling) fourth pillar of social insurance in Australia*, Luxembourg wealth study working paper series, no. 8.