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A social agenda for equity and efficiency

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Introduction

With the economy and employment levels growing strongly, Australians have never been better off materially and, as consumers, they have more choice and diversity than ever.

But with greater economic prosperity has come a shift in policy norms and values. Governments have become insensitive to societal problems they would never have tolerated 30 years ago. This is evident in the high degree of policy inertia towards the long-term unemployed, the underemployed and the growing numbers of jobless working-age households. It is evident in the drift to low-paid casual or part-time jobs, where workers (albeit with some wage loading) are forced to accept unpredictable working hours, uncertain incomes, and a loss of sick leave, holiday leave and training. It is evident in the meaner and more demeaning treatment of many welfare recipients and the steady reorientation of welfare spending towards ‘middle class’ benefits. We can see it in the declining progressiveness of the tax system, the reluctance of governments to borrow to finance essential social infrastructure and the erosion of the old ‘social wage’ (non-cash government services) as a redistributive tool. All these policy developments are impacting on the social fabric—with growing work-related stress claims; increasing inequality of final incomes and wealth (both across households and spatially); and widening disparities in education, health and housing outcomes between high and low-income households (Argy 2003; Lloyd 2004). The old ‘worker welfare state’ is changing beyond recognition.

Why is this happening? We hear it said that egalitarian policies are no longer economically affordable; that social spending has become largely ineffective or even counterproductive; that the current and prospective ageing of the population is making redistribution less feasible; and that, in any case, Australians are less committed to egalitarian values. I will look critically at these claims in the first part of the paper and argue that, for the most part, they are little more than ‘small government’ ideology.

But, realistically, one must accept that the underlying political perceptions are deeply entrenched and will be hard to shift. So we should look for ways of repackaging social policy to make it fit better with the opinion climate as it now exists. This might mean putting less policy emphasis on income inequality per se, and more on quality of life and equality of opportunity goals. This is the broad theme of the second half of the paper.

1. The driving forces

What has been driving the retreat from old social norms? The most commonly mentioned suspects are:

1. A cultural change in community attitudes
2. Economic imperatives
3. A dysfunctional system of redistribution
4. The need to plan for an ageing population
5. A shift in society’s power structure.

Changing cultural attitudes

Has there really been a big shift in community values and preferences? Are Australians becoming more individualistic and materialistic?

There is no doubt that Australians have conservative social values. Surveys have consistently shown that, across the social structure, Australians generally want to see merit, education and enterprise well rewarded, dislike taxes that penalise effort and innovation, are distrustful of governments generally and respond coldly to the goal of equal outcomes[1].

But this has always been so. There is no hard evidence that social conservatism has *increased* since the 1970s. Australians are perhaps becoming a little more accepting of inequality (Saunders, 2003; Kelley & Evans 2001 and 2002[2]. And it is possible the tougher job environment for many low-income workers (which is breaking down class loyalties, workers solidarity and the sense of community) may have hardened attitudes to passive welfare for people of working age (Argy 2003).

However, survey evidence shows that, for the most part, Australians remain unhappy about the direction and pace of social change, dislike rising inequality and strongly support the goal of equal opportunity (in employment, educations, access to services etc.). This is why they do not like wide earnings inequalities between the top and low-end jobs (Kelley & Evans 2001 and 2002). It is also why Australians are generally unhappy about the trend to user pays and privatisation of public services (Meagher 2004) and why, in increasing numbers, they are prepared to pay significantly higher taxes to improve community and public services like health and education. Indeed, the earlier trend showing a preference for lower taxes over increased social spending reversed itself in the 1990s (Wilson & Breusch 2004)[3].

If my reading of the poll evidence is correct, cultural change may explain a small part of the egalitarian policy retreat and the shift from public to private goods, but overall the change has gone considerably further than most Australians appear to want.

Economic necessity

A second pervasive claim is that the economic costs of redistribution have increased since the 1970s. This claim is correct in only one very special sense. In today's globally integrated economy, it would be economically retrograde to revert to the old distorting instruments of social protection, such as widespread industry protection, extensive wage and workplace regulation, cross-subsidisation of government services and interest rate controls. Such measures tend to alter the relative prices of various goods and services in ways which are unrelated to the social opportunity cost of producing these goods, thus reducing resource allocation efficiency. More importantly they prevent the operation of full

[1] E.g. see various Melbourne University surveys (reported in *Australian Social Monitor*).
[2] The proportion preferring social spending to lower taxation is well below the level of the 1960s.
[3] Wilson and Breusch found that in 1987, two-thirds of respondents said they preferred lower taxes, whereas by 2003, 42 per cent preferred tax cuts over higher spending. See also Roy Morgan Research poll (cited in ACOSS media release 15 October 2003) and Argy (2003).

competitive disciplines—a major driver of innovation and efficiency—and impede the flexibility and adaptability of the economy.

But few are asking for a widespread return to these old regulatory instruments, other than at the margin. The issue we are all addressing is whether increased social intervention through direct budgetary measures such as taxes, borrowing and well-targeted spending would damage our economic prosperity. And here the arguments are much more evenly balanced.

Like most other economists, I accept that higher taxes can pose significant risks for economic efficiency because of their effects on work effort, saving, risk propensity, innovation and administrative and compliance costs. But the costs can be kept down by selecting revenue-raising devices which have a neutral effect on the work/leisure choices of households and minimise the risk of capital flight[4] and by financing more of our up-front investments in long-life social infrastructure out of borrowings and less out of recurrent revenue[5]

Moreover, as I will explain later, social programs have many economic benefits on the spending side (such as for productivity and workforce participation) which are frequently overlooked. These benefits on the spending side—which are at their greatest if principles of good public management are followed, such as clear definition of goals, tight targeting, accountability, regular review and administrative simplicity—need to be weighed against the disincentive costs on the financing side. Once this is done, the economic balance sheet on redistribution appears to be at worst slightly negative and at best slightly positive. Despite the trend increase in tax and spending levels relative to GDP since the 1960s, Australia remains a 'small government' country by most international standards and for such countries there is no clear relationship between social spending and economic performance (Argy 2003, chapter 2[6]). Even if there are some net economic costs, they are certainly much more affordable today than they were in the 1970s, when, on a per capita basis, we were not even half as well-off as we are now.

That is the view of most academic economists but it is not the view of the policy elite and our political leaders.

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[4] Such as by

- removing the existing preferential treatment of capital gains
- imposing new taxes on the value of holdings of unimproved land, or on inheritances
- taxes on carbon emissions or congestion
- clamping down on tax minimisation practices and
- if income taxation has to be increased, by targeting those with the lowest elasticity of supply.

[5] The present policy stance of zero net *public borrowing* over the business cycle is impeding the nation's capacity to meet its infrastructure needs, contributing to the retreat from Australian egalitarian values and creating a 'democratic deficit'. Yet it does nothing for intergenerational equity. I also reject the idea that higher public debt levels would destabilise global financial markets. Financial markets and rating agencies are not stupid. They know that Australian governments are low spenders (on any international comparison) with strong balance sheets. Financial markets would not turn nasty if Australia chose to borrow more for long-term infrastructure, so long as the spending was of the productive kind, socially and economically. Some credit rating agencies have been recently telling us so unambiguously (Mike Steketee in *The Australian*, 14 April 2004).

[6] Ironically, Roger Kerr (2003) presents cross-country analysis purporting to show that 'economic growth declines as size of government increases', but a close reading of his own statistical evidence shows that this conclusion is heavily affected by some extreme readings. For a very wide range of 'middle' countries with government expenditure of 30 to 45 per cent of GDP (with Australia at the lower end of this range), there is no evidence of correlation between government spending and GDP growth.

Ageing of the population

There has been much debate about the prospective ageing of the population, with its potential to halve the number of workers per retired person by 2042 and leave future Australians with a large revenue gap of 5 to 8 per cent of GDP. This has led many to warn that governments should be trying to lighten our children's burden by curbing current spending on health and welfare and further running down public debt levels. If this advice were taken, it would pose yet another threat to egalitarian policies.

In my view, however, the concerns about the ageing population are greatly exaggerated. To begin with, the fiscal effect of the prospective increase in dependency ratios does not start to assume serious proportions before at least another 10 to 15 years, reaching its peak in 2042. By then the problem will have partly corrected itself through normal market processes. Acute labour market shortages will force employers to adopt a more positive attitude to recruitment and training of older workers. And older citizens will be healthier and have a longer life expectancy, so they will be much more eager to work into their late 60s. And if future governments do not wish to rely solely on the market response, they will have a range of policy options available to them to encourage greater work participation and hence reduce future dependency ratios. For example, in addition to the tentative steps already taken by the Howard Government, they could make it more rewarding for older people to work longer by lifting the bonus paid to people of retirement age who delay their retirement; and they could try to reduce the poverty traps faced by single parents and disability pensioners through a rationalisation of the tax and income test systems, better child-care facilities, etc.

If after such market and policy responses there is still a residual 'revenue gap', it could be left to future Australians to bear. Remember they will be nearly twice as rich on average in 2042 as now. As for the argument that we should be lightening the load on our children, does it make sense to defer investment in key areas of economic and social infrastructure in order to leave future Australians with less net public debt if the upshot is less net public wealth?

While the fears about ageing are greatly exaggerated, the public rhetoric has become powerful and it is leading to policy conclusions that could further erode our egalitarian values.

Has the social security system become dysfunctional?

Another political concern driving the retreat from egalitarian policy values is that social spending has become less effective—that 'over-generous' social security provisions are creating a dangerous culture of welfare dependency.
I have argued (Argy 2003) that the causal link is not from higher social spending to welfare dependency, but mostly the other way round.

This is not to say that our system of redistribution is operating at optimal effectiveness. It does have some problems. One relates to 'middle-class welfare'. Some universality is necessary to maintain community support for needs-based spending and to avoid welfare traps, but the recent explosion in middle-class benefits—for many self-funded retirees, new home buyers, new mothers, private schools and private health insurers—has made our transfer system less effective as an instrument of redistribution. Another problem is that some welfare recipients—such as many of our single parents and disabled persons, who are not work tested—do not have enough financial incentive to move into jobs. And it is arguable that our system of redistribution relies excessively on an inefficient instrument of redistribution—viz. relatively high minimum wages. This could be making it hard for some low-skill workers to obtain employment.

But these problems are fixable efficiently and equitably (see later). Overall, Australia still has one of the most cost-effective tax/transfer systems in the world in terms of the equity mileage from each incremental dollar spent.

But the media and political perception is different—and it is being reflected in the political rhetoric, which in turn is having some effect on community attitudes.

The shift in power structure

One of the major drivers of the retreat from egalitarian policies is the shift in the structure of power in Australia.

While globalisation has not greatly altered the economics of redistribution, it has fundamentally transformed the politics of redistribution. For one thing, it has narrowed the scope for governments to tax mobile capital and corporate income (so they have tended to focus principally on taxes that impact on ordinary workers). This is not in itself an insuperable obstacle as there are perfectly good alternatives available. The more crucial point is that the new power players spawned by globalisation—deregulated financial markets, rating agencies and free-to-roam multinationals—have generally anti-egalitarian interests and values and have sufficient clout to influence the economic, financial and political climate if policy is moving in the ‘wrong’ direction. These key players do not conspire together—they are mostly uncoordinated, faceless and invisible. They influence policy by sending ‘signals’ to governments through the markets and by creating doubts and fears in politicians’ minds.

If the earlier analysis is correct, the anti-egalitarian ideology of this new financial power base often conflicts with Australian values. So how do politicians get away with it? One important way is through information management[7]. Why do they do it? For conservative politicians the answer is simple: they share the same values as global market players. But why do social democratic governments and political parties go reluctantly along with this? In my view it is because they are intimidated by global capital and financial markets. Some believe they are also intimidated by their Treasury bureaucratic advisers—but in my view that role has been somewhat exaggerated (Argy 2003).

In short, at the political level, ‘hard liberal’ political ideology—the belief in small government (low government spending and regulation) and freedom of choice and self-

[7] Opinion manipulation by governments, media and key business interests occurs through several mechanisms which are discussed in chapter 6 of my latest book. These include: information management, vilification of hostile groups, distraction of voters by other issues and use of self-imposed arms-length fiscal rules such as zero net borrowing which are then treated as sacrosanct.

reliance as desirable ends in themselves—has become dominant, and this explains more of the shift in policy norms than the economic, cultural and demographic forces noted earlier.

2. The need for a new approach

Whatever the precise reasons for the egalitarian retreat, there is little prospect that it will be reversed, at least in regard to the role of passive welfare, given the state of public opinion.

What can be done to repackage social policy to better accommodate at least some of the existing policy perceptions? In my view it requires an attack on two fronts.

One involves redressing, at least in part, the effects of economic growth on the quality of life of Australians (their management of leisure, work-family balance and their living, working and natural environment). For this objective, 'neutral' fiscal policy intervention has only a limited role. The main instrument needs to be social regulation. But regulation has a relatively high economic price tag. For example, an attempt to improve workers' quality of life through stronger award regulation might well reduce labour market flexibility and slow national productivity growth (as conventionally measured). So the community would effectively have to decide whether it wanted to forego some real wage increases in exchange for improved working conditions, more predictable hours and greater job security. Opinion polls suggest that, if the issues were properly explained to them, most Australian workers might, on balance, accept such a trade-off. But it is a big topic for others to develop[8].

The second line of attack, which is the focus of the rest of the paper, involves more active promotion of 'substantive equality of opportunity'. An equal opportunity agenda needs to go beyond preclusion of overt forms of discrimination on the basis of ethnicity, religion, gender, age, etc. It must actively seek to improve the long-term competitiveness of children and youth disadvantaged by low parental income and education, location, disability or abuse. It must also give a leg up to those who start too far behind the rest of the field, such as indigenous Australians who have suffered a history of discrimination or alienation and migrants with poor knowledge of English.

An equal opportunity agenda

An equal opportunity or 'active' agenda, in contrast to 'passive' welfare spending[9], seeks to reduce underlying inequalities of starting opportunity (although not inequalities stemming from differences in effort, motivation, skills, risk attitude and innate intelligence). It could be mostly implemented through 'direct' budget measures, thus minimising the risk of potentially distorting effects on the economy and include assistance and incentives to:

- help indigenous Australians overcome their special health and education handicaps
- assist families at risk of long-term social and economic disadvantage

[8] Hamilton (2003) and various Australia Institute reports have sought to tackle elements of this bigger topic.

[9] Passive welfare refers to unconditional cash or income transfers which are subject only to evidence of need and in some cases a job search requirement.

- enhance the employment opportunities available to, and job readiness of, the long-term unemployed and unskilled youth
- reduce the ‘poverty traps’ facing many of our single parents and disabled people (e.g. through earned income tax credits or other income supplements designed to ‘make work pay’)
- improve access by low-income families to vocational training and education, housing, health, transport, child care, electronic information services etc.
- reduce the special disadvantages (such as in employment, education and health) experienced by people in geographically isolated areas or suburbs
- help low-income families build up savings, superannuation and education accounts and to access credit, to offset the effects of wealth inequality and imperfect credit markets
- protect vulnerable workers from exploitation (e.g. giving them better control of their working hours and working environment and better access to trade unions), even it means a little more regulation.

Well-designed and implemented, such a program should prove very socially effective and (as argued later) should have sufficient positive economic spin-offs to outweigh the effects of higher taxes. However, care will be needed in the choice of instruments. For example, there are doubts about the cost-effectiveness of some active labour market programs but many have a good record (Martin 1998), including:

- closely monitored, limited-duration employment subsidies
- earned income credits
- training programs targeted to the specific needs of both job seekers and local employers
- subsidised business start-ups for some of the unemployed
- early intervention policies reaching back to preschool, targeted at at-risk students
- job-search assistance programs
- in-depth counselling and customised, intensive services.

An ambitious equal opportunity strategy will not gain political support if it only offers ‘carrots’, without any ‘sticks’. Both major political parties, conscious of the present political and community climate of opinion, argue that governments need to inject an element of compulsion and encourage and facilitate self-reliance and individual responsibility (‘help people to help themselves’). They want welfare recipients, in return for assistance, to ‘give something back’, for example by agreeing to retrain or relocate to areas where the job market is stronger or by participating in various work and community employment schemes.

Like many other Australians, I have always considered welfare to be a ‘right’ for anyone in need, but I have to acknowledge that the current preponderant public view is that government assistance (for people other than the aged, frail and disabled) should have some reciprocal obligations. It is why they support work-for-the-dole and the extra compliance demands being put on the long-term unemployed and why HECS is firmly embedded in the political ethos and the search is on for ways of extending it beyond higher education.[10]. This is the hard reality which needs to be accepted.

How will an equal opportunity policy agenda help deal with the adverse political perceptions?

An active social agenda, which combines income support with (a) early intervention policies, (b) adjustment assistance to facilitate workforce participation and (c) some reciprocal obligations, would not only be effective in promoting more equal opportunity but would also have useful political and economic spin-offs that would make it more politically acceptable than mere passive welfare on its own.

Firstly, active social policies reduce the risk of welfare dependence in the long term. Passive welfare policies seek only to alleviate hardship and can create perverse economic incentives: for example our age and disability pension arrangements are thought to discourage saving and employment. So they may conceivably widen *market income* inequality, while still reducing *final income* inequality. On the other hand active policies (in areas such as education, low-cost housing, child-care and labour market programs) not only alleviate hardship but also seek to increase work participation in the longer term. So they tend to reduce market inequality—the root cause of welfare dependence—with compounding benefits for final income inequality.

Secondly, active social programs help allay concerns about the prospective 'revenue gap' in 2040 and later, associated with an ageing population, because, while they generate short term budgetary costs, they also work to reduce the total burden on revenue in the long term.

Thirdly, active social programs get closer to Australian values because they promote a society which assists its citizens to overcome the handicaps of birth and poverty (through scholarships, health support, skill enhancement facilities, better access to transport and child care, etc.) while expecting citizens to do more to improve themselves. Equal opportunity in this sense is a concept to which Australians respond warmly. It is part of what Australians see as a fair go.

The fourth big advantage of active social policies is that they ease concerns about the economic costs of fiscal redistribution policies in ways which passive welfare alone cannot. This needs a little elaboration.

On the revenue side, there are (as indicated earlier) some economic costs associated with higher taxes. With passive welfare, these costs are potentially open-ended; but with active policies there are at least some self-correcting forces built in, so the cost are likely to be less sustained. This is the first economic advantage of active policies.

Active policies score even better on the spending side of the equation.

[10] For example, bridging financial assistance to home buyers suffering from temporary economic hardship with repayment (called 'Housing Lifeline') or a 'home credit fund' targeted at people on welfare to encourage them to move into employment could both be on a similar basis to HECS.

Both passive and active policies relieve poverty and thus help recipients maintain their skills as well as their health during the stressful and difficult period of joblessness, making them more productive when they re-enter the work force. They both create a better environment for the development of children. They both help promote greater social and political stability and reduce crime rates—outcomes that are good for society but also the economy. By spreading the gains more evenly across the population, they both reduce the risk of a community backlash against future structural change and reform. As well, with adequate cash benefits, workers, unions and employers are less likely to resist lay-offs—sometimes a necessary part of the structural adjustment process—and retrenched workers are less likely to hastily take unsuitable employment e.g. at much lower skill levels.

These are important and often overlooked benefits of passive welfare. However active social policies have additional positive economic spin-offs arising from the way they respond to market failure. A fundamental problem with free markets is the uneven playing field for jobs, stemming from unequal starting opportunities. Passive welfare seeks, through the tax and transfer system, to alleviate the effects on final income of this market failure. But active policies go to the root of the problem: they try to remedy the market failure itself, so they generate better social and economic outcomes in the long term.

Take for example the policy response to long-term unemployment and underemployment and discouraged workers. Governments can simply relieve their plight with passive income support and do nothing more. On the other hand, they can also, with active labour market and structural adjustment programs, try to improve their skill base or help them move to better locations or create jobs that they can better fill. And through earned income credits they can make it more rewarding for welfare recipients to work. The result of such active intervention is a better match between job vacancies and job-seekers, a reduced risk of long-term loss of employability and an increase in work participation and economic growth. Thus, as well as helping long-term welfare recipients, the policy corrects an intrinsic failure in the labour market.

To take another example, the provision of low-cost housing, credit insurance schemes and incentives for low income earners to save all help to correct the tendency for credit and rental markets to be biased against asset-poor people with irregular incomes. This is because of asymmetric information (leading to a tendency for lenders to exaggerate the risk of inability to repay or to pay rent). So people with casual, insecure jobs or seasonal jobs do not have an equal chance to develop their capacities to the full (in terms of skill enhancement, self-employment and job preparation). Conversely, some people with wealth but limited ability may over-invest in skills and entrepreneurship. Equal opportunity programs thus serve as a partial substitute for imperfect or missing credit and insurance markets and thereby help to improve national productivity.

Again, education and training assistance tackles a particular failure in the market for education—the bias in favour of children living in high-income, well-educated households relative to those in low-income households with equal capability. Early intervention strategies targeted at low-income families could help offset this bias.

In short, the economic balance sheet on redistribution is much more positive for active than for passive social measures. In fact, with active policies, there is a reasonable theoretical presumption that the economic benefits would exceed the economic costs. This theoretical presumption is strongly confirmed in a recent empirical study by the OECD (Arjona et al. 2001) which found that an increase in active social spending is 'good for growth'.

Concluding remarks

I have suggested that social reformers might need to reframe and repackage their policies in such a way as to alleviate the concerns about economic costs and welfare dependency. The kind of social agenda they should aim for is one which provides basic income support but which also:

- reduces the long-term competitive disadvantage of the poor in the job market
- facilitates the process of longer term personal and structural adjustment
- includes a considerable self-help element.

This is not to lessen in any way the importance of a strong and generous income support system. Indeed, many social security benefits are too low and need urgently to be raised to levels more consistent with community standards and human dignity. And there is a case for a further easing of welfare penalties. But social reformers need to work on two fronts—poverty alleviation and more equal opportunity programs.

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