

# UNIVERSAL INCOME SUPPORT

## TWO

### [Selective Income Support](#)

#### 1. Introduction

**If**, and this must be emphasised, **if** the objective of a national welfare program is to provide financial or other assistance to those in need, then selective or targeted income support is an essential foundation for the development of such a program.

If the objective is to provide assistance to those in need, then in simple terms targeting means identifying those people who are regarded as being in need. But how do we define "in need"? How do we assess that individuals or families are in need, and the level of assistance required?

In the context of a system of income support, "in need" must be defined in monetary terms. There must be some form of assessment of income and assets (means test) to determine not only those who can be identified as being in need, but also the level of financial assistance required to ensure they are no longer in need. To be fully effective - i.e. to be able to accurately decide who is in need - targeting must be accompanied by means testing.

The objective of providing assistance to those in need also implies that the assistance will be sufficient to alleviate the need - to alleviate the immediate need. The process of targeting and means testing is admirably suited to this role. It can be said that if the objective is to alleviate need, then the most efficient way to achieve this objective is with means tested income support with a 100 per cent withdrawal rate - i.e. the benefit will be reduced by one dollar for each dollar of private income. **No person will receive a benefit greater than or less than is necessary to be assessed as "no longer in need"**.

It can be questioned, however, whether the process is suited to longer term needs, or to a national system with extensive coverage requiring identification through categories of people with some common element of possible need.

In Australia, for example, the national system of income support includes a number of categories defined by age, marital status and family structure, ethnicity, employment, disability, etc. The system is relatively straightforward, providing financial support based on a process of targeting and means testing. This process identifies those in need and assesses the degree of need - income support is then directed towards these needs. Yet there are mixed views about the efficiency of the system, extending from support for the comprehensiveness of the system to concern that support is being directed to people not in need?

On the one hand there is the view that the system is comprehensive and well targeted.

*Because Australia's welfare state is both reasonably comprehensive and targeted according to need, it is able to help in a more cost-effective way than many other countries. 1.*

*On many indicators, Australia's welfare system compares well with those of other countries. It combines comprehensive coverage with efficient targeting and effective poverty alleviation. 2.*

On the other hand there is the view expressed in the textbook "Economics", under the heading "The Welfare Mess":

*Critics charge that the willy-nilly growth of our welfare programs has created a clumsy and inefficient system, characterised by red tape and dependent upon a huge bureaucracy for administration.....The regulations of many income maintenance programs are such that those who are not needy may benefit. 3.*

Why this wide range of views? Is it attributable to the process of targeting and means testing and how suited this is to a national system? Or is it attributable to the objective of the system, and how clearly and accurately this is defined?

## 2. Defining need

Targeting and means testing can provide a sound basis for a system of income support designed to alleviate need, but it must be absolutely clear that the objective is to "alleviate need", and "need" must be clearly defined. If the objective goes beyond alleviation of need to include prevention of need, or prevention of welfare dependency, for example, then targeting and means testing is not the way to go.

Today it is estimated that almost one third of Australia's population is in receipt of or supported by government funded income support. ( 27 per cent of all adults were "on welfare" in 1997) Is it conceivable that almost one third of Australia's population is in need, or has the process failed to identify genuine need?

It has also been reported that the poorest 30 per cent of Australians are classified as "poor", but they only receive 60 per cent of welfare payments. Is it conceivable that 40 per cent of welfare payments are directed to the non-poor - i.e. to those with incomes above the lowest 30 per cent?

Or should being classified as "poor" extend above the lowest 30 per cent? Is it conceivable that over 30 per cent of all Australians can be classified as "poor"? Do these indicators point to a significant amount of "middle-class welfare" in Australia. 5.

Are these results an indictment of our economic policies or of our social policies? Or are they an indictment of other factors? Are they an indictment of the process of means testing adopted to identify people in need within categories? Or are they an indictment of successive governments which have based the national support income system on principles not suited to the task, and have permitted or even extended payment of income support to people not genuinely in need?

With the concern in Australia today that the sheer numbers of people receiving or dependent upon income support points to a system which has expanded beyond the principle of "helping those in need", there surely is a case for questioning the basic foundations of the income support system. One may even question whether Australia's income support system has ever been based on the principle of helping those people who are in need.

Development of Australia's income support system commenced in 1909 with payment of age and invalid pensions. These pensions followed the pattern of pension payments introduced by Victoria and New South Wales just prior to Federation. In these States (then Colonies) their decisions were taken following Reports and a Royal Commission recommending selective schemes to minimise costs and to direct assistance to the deserving. The end results were non-contributory, targeted and means tested pensions.

Eligibility for the Federal age pension followed the State conditions, with a minimum age of 65 (reduced for women to 60 in 1910) and a maximum single pension rate of 10 shillings per week, which was then just over 18 per cent of the average weekly wage of 55 shillings. The means test provided for a pension withdrawal rate of 100 per cent for income in excess of the allowable level.

At no stage prior to the introduction of the age pension did the Federal government claim that the rate of pension would be based on a measurement of poverty or an assessment of being "in need", and at no stage since has this claim been made with any validity. This leaves open to doubt the claim that the pension scheme was, and still is based on helping those people who are "in need".

Even today there is no clear view of what constitutes poverty in Australia. We do know that researching the concept has kept many researchers busy for many years.

Is poverty to be measured in objective terms - i.e. expressed in dollars and cents according to cost of living data? Or is it to be measured in relative terms - in terms of inequality? In the words of Robert Haverman:

*While poverty concerns the number and status of those in the bottom of the distribution of economic well-being, inequality has to do with the general spread of the distribution - the gap between the rich and the poor. 4*

Theoretically, if poverty can be measured in objective terms then income support properly targeted and means tested can eliminate poverty. But can poverty be accurately measured? Again quoting Robert Haverman, the answer is "not likely", and this answer is supported by the lack of success by researchers in recent years.

*The concept of poverty.....is elastic, multidimensional, nonobjective and culturally determined. No objective measure of it can be either totally satisfying or accommodate more than a few notions of what it means to be "poor". In that sense, efforts devoted to defining and measuring poverty are doomed before they begin. 5*

The Australian Government Commission of Inquiry into Poverty chaired by Professor Henderson in its First Report, 1975, estimated levels of poverty (later known as the poverty lines) based on individual and family needs, but they were never accepted as a basis for establishing rates of pension payments.

Relating the basic rate of pension to Average Weekly Earnings may be construed as an intention to reduce inequality rather than to eliminate poverty, but in reality it has been a result of political decision making. **Today, just as in 1909, the basic pension rate reflects what the government of the day considers a fair and affordable base rate.**

### **3 Tapered means test**

Expressed as a percentage of average weekly earnings, the basic pension rate has increased from 18 per cent in 1909 to 25 per cent today, a considerable increase, but over a long period of time. This increase perhaps reflects revised assessments of the basic needs of an individual, but in hindsight it more likely reflects what successive governments have decided they can afford to pay.

In relation to the means test, however, there has been one significant change - a reduction in the withdrawal rate. In 1969 the 100 per cent withdrawal rate, i.e. one dollar of pension for each dollar of income, was reduced to a 50 per cent withdrawal rate, i.e. 50 cents of pension for each dollar of income. The immediate effect of this change was twofold. The stated objective of the income support system of helping people in need was extended to incorporate what was described as a "reward for saving". And the cut-off point for payment of a part pension was extended to include what were previously considered to be "non-poor".

Prior to 1969 the coverage of the national income support system had gradually been enlarged to include child endowment (1941), widows' pensions (1942), maternity allowances and funeral benefits (1943), and unemployment benefits (1945). These pensions and allowances, together with age and invalid pensions, were incorporated into the Social Services Consolidation Act of 1947, formalising the development of a comprehensive system of income support. This was completed in 1976 when child endowment and tax rebates for children were amalgamated to become family allowances.

With the wide range of benefits and a common means test the national system in the late 1970's and 1980's was likened to a guaranteed minimum income scheme - a likeness that continued until the introduction of conditional unemployment benefits in 1991.

In retrospect it can be said that the introduction of the tapered means test in 1969 was possibly the most significant change to the income support system after the 1947 Consolidation Act. There have been quite significant changes to individual pensions and allowances, but the effects of the tapered means test were, and are still felt across the whole range of benefits. Following are four significant effects of the revised means test.

a. **A reduction in the disincentive to work and to save.** Means testing of income support creates a disincentive to work or to save. This has long been recognised, and the greater the withdrawal rate the greater the disincentive. Reducing the rate from 100 per cent to 50 per cent was a move in the right direction to reduce the disincentive, but it still left an effective marginal tax rate (EMTR) of 50 per cent, a rate much higher than the lowest income tax rate.

When the tapered means test was introduced in 1969, unemployment was still in the vicinity of 1 per cent. The disincentive to save was of far greater concern than the disincentive to work. People who were thrifty and saved for their retirement were often not eligible for a full or even a part age pension because of their private income, whereas people who had spent their income and neglected to save were entitled to a full pension. This was seen as a social anomaly, and the declared justification for the tapered means test was as a reward for saving.

Introducing a tapered means test may have reduced the degree of disincentive, but as evidenced by later changes to unemployment benefits there was a recognition that a disincentive still remained. In the 1990's eligibility for the unemployment benefit became subject to work or training tests, eventually leading to the current "work for the dole" program and to emphasis on preventing "welfare dependency".

**b. Redefining the objective of the income support system.** Initially the objective of the income support system was perceived to be to help people in need - and to provide relief through the payment of income support.

However, the objective was never as precise as depicted. Prior to 1969 there has always been a small amount of allowable private income included in the means test. In effect there has always been a small range of income levels at which a pensioner was declared no longer in need. Following the introduction of the tapered means test this range of income levels was considerably extended through the additional reward for saving.

Today there is a very wide range of income levels for which some income support is payable. For example, for a single pensioner and excluding pharmaceutical allowance, allowable income at March 2000 was \$51 p.w. and the basic pension rate \$186 p.w. If the 100 per cent withdrawal rate had been retained the range of incomes for a pensioner to be declared "no longer in need" would be from \$186 to \$237 p.w. However, with a 50 per cent withdrawal rate the range of incomes is now from \$186 p.w. to \$423 p.w.

With the tapered means test the reward for saving is now greater than the level of pension benefit. The emphasis has changed from alleviating need to rewarding saving.

This change in emphasis has also reduced the ability of the income support system to reduce income inequality. An increase in the basic pension rate of one dollar will result in an increase in the "reward for saving" of two dollars. An increase in the basic pension rate increases inequality. Targeting and means testing is just not suited to any income support which embraces a withdrawal rate less than 100 per cent.

**c. Middle class welfare.** Middle class welfare is a term which by common usage describes the provision of welfare assistance to people who would not qualify as being "in need". Eligibility for assistance is based on factors other than poverty or inequality.

The high reward for saving attributable to the tapered means test is an example, with eligibility for a part pension extended to people with incomes far in excess of the basic pension rate. Reducing the withdrawal rate to reduce the disincentive to work or save extends payment of the benefit to people not previously regarded as being "in need". Reducing the withdrawal rate increases inequality and increases the probability of middle class welfare.

A second avenue for increasing "middle class welfare" with a tapered means test is in association with occupational superannuation benefits. The provisions for rolling over funds into superannuation enables people to increase their superannuation pensions and still retain eligibility for a part age pension. For example, it is now possible for a retired person to have superannuation pensions totalling more than double the basic single pension rate and still be eligible for a part age pension. It is also possible for a person with assets in the vicinity of \$500,000 to arrange these investments by utilising occupational superannuation to ensure eligibility for an age pension benefit. It is difficult to imagine a person with assets in excess of \$500,000 being identified as "poor"! Examples such as these destroy the rationale of taxation concessions for occupational superannuation.

Retirement benefits funded through a contributory system such as superannuation or insurance attracting government subsidies or taxation concessions favour the rich. There have been claims that the potential for middle income welfare in Australia has been far less than in other countries, largely because of the comprehensive cover of the wide-ranging income support program. This claim may have been valid in earlier years, especially when comparisons were made with countries with contributory insurance benefits and taxation concessions favouring higher income earners. However, the rapid growth of occupational superannuation funds in Australia has changed this scene. Today Australia can be seen to be in the forefront of changes encouraging growth in the extent of middle class welfare, and this can be attributed not only to the changes in the means test formula but also to the growth of superannuation funds. There is a perception of government policy encouraging growth of the middle class.

**d. Political considerations.** Introduction of the tapered means test led to changes far wider than the immediate increase in costs of the income support system. The introduction led to a change in approach, with greater community acceptance of the principle of maximising financial assistance from the income support system in much the same way that minimising income tax is accepted. The introduction also led to a change in approach by government which facilitated intervention in the administration of the income support system to the extent that the system today appears at times to be a vehicle for the imposition of political ideology.

There was an immediate increase in the cost of the income support system through the extension of eligibility for a pension benefit. This was anticipated and considered affordable. What was not anticipated, however, was the opportunity it provided for pensioners, and in particular age pensioners, to adjust their investment income to ensure receipt of a pension benefit. Receipt of a part pension, however small, was valued because of the medical and other benefits it provided.

Successive governments attempted to counter efforts to maximise pension eligibility. The means test was amended to include both an income and assets test, requiring the establishment and maintenance of financial records for over 1 million individuals and families. This created an enormous administrative problem which was not envisaged when the tapered means test was introduced in 1969, and highlighted the unsuitability of the process of targeting and means testing for a national system of income support.

To help deal with this administrative problem the means test was further modified by including deemed rates of income for specified investments. Accuracy gave way to expediency. Today the means testing procedures are a compromise between administrative efficiency and practicability, and the problem of unfair entitlement is still with us. As stated by the Minister for family and community affairs:

*Some wealthy people are using private trusts and private companies as a way of getting entitlements to social security payments when they are clearly able to support themselves.* 7

Besides responding to the changed approach by people in the community, governments have themselves changed their approach to the provision of income support. The move away from helping people in need flowing from the tapered means test has enabled successive governments to introduce greater flexibility into the operation of the system. There is no longer a common means test for all beneficiaries. e.g. For age pensioners a means test based on assets and income but with deemed interest rates - for family beneficiaries with fluctuating wage income, the income test can be based on the previous year's taxable income - and for the unemployed a special means test of their own in conjunction with conditional benefits.

This flexibility has led to a fundamental change in the approach by government - a fundamental change in the role of the state.

With a means tested system based on 100 per cent withdrawal, such as existed prior to 1969, the role of the state was seen to be one of providing a safety net - i.e. ensuring all citizens receive at least a common level of income sufficient to provide a basic standard of living.

However, with the change in the objective of the support income system the role of the state changed. This role has now become one of helping people maintain the standard of living to which they are accustomed. This is a role inherent in income related benefits, and acceptance of this changing role was reinforced with the introduction of occupational superannuation.

This change has enabled governments to target groups in the community for reasons other than being in need. It is now possible to use the income support system to target groups and provide special support which is really outside the scope of welfare, e.g. childcare and regional costs. Income support is now directed to help people maintain their lifestyle rather than help people in need.

Let's not fool ourselves. Australia does not have a national support income system dedicated to helping those in need. In fact Australia does not have a single national income support system but rather a number of systems devoted to categories of people.

#### **4 The pattern for the future**

The introduction of the tapered means test not only contributed to an enormous blow-out in the costs of income support, but also extended the basis for eligibility far beyond helping people in need. There may be still a "safety net" incorporated in the process, but the emphasis is now on political policy rather than on welfare policy - on economic policy rather than on social policy.

This should be of particular concern in an economic environment which favours the middle class.

In a capitalist world the pattern for helping developing countries is to establish a strong middle class to provide a

skills and market base, and a low wage working class to provide the labour pool to encourage investment. There is the view that future prosperity will trickle down to the working class, a view now refuted by most economists and politicians who see growth in the size of the middle class (the winners and losers syndrome) as a more realistic outcome and an objective with more electoral appeal. The working class must remain if the spirit of Adam Smith is to survive.

This also appears to be the pattern for developed countries. It certainly is a pattern evident in the development of the Australian social welfare system. It is a pattern evident in education and health policies, in our legal system, and in our income support systems. It is a pattern that is supported by fragmentation of the income support system, and the consequent fragmentation of the objectives of the system.

The appointment of the Reference Group to advise on income support for one section of the community is evidence of this fragmentation - the May 2000 budget added further confirmation. This fragmented income support system in Australia facilitates the growth of middle class welfare in all categories of people except one - the category of the unemployed. This is the category with the strongest case for reducing disincentive, yet it has the highest degree of disincentive, with a means test including a mixture of 100 per cent and 50 per cent withdrawal rates.

Despite statements at the 1999 Liberal party national conference of a renewed emphasis on social policy, the only statement of objectives has been from the Minister for family and community affairs when announcing the appointment of the Reference Group in 1999. Described as pertaining to welfare in general, these objectives apply specifically to one fragment of the income support system only - to the benefits for the unemployed. These benefits have been the most politicised by modern conservative governments - they are the benefits with the highest disincentive to work, and the only benefits with conditional eligibility.

*The modern conservative approach to welfare emphasises three main objectives. The first is to assist people appropriately when they are in genuine need, to provide an adequate safety net. The second is to stop people becoming dependent, to the extent possible. The third is to help people move to independence as soon as possible.* 8

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