

# DO WE STILL NEED THE WELFARE STATE?

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## **The demise of the welfare state**

Nearly twenty years ago<sup>1</sup> I suggested that western, capitalist countries are in long-term transition from the predominantly *market mode of consumption* characteristic of the nineteenth century, through a *socialized mode* which lasted for much of the twentieth, and towards what I called a *privatized mode of consumption* emerging today. Seen in this way, the socialized mode, exemplified by the mass welfare state, is historically transitional, for the circumstances which brought it into being are now disappearing.

In the nineteenth century, people were expected to make provision for their basic needs through market transactions and self-provisioning, and when these failed they relied on charity, philanthropy, mutual aid and a rudimentary system of official poor relief to get by. Industrialisation, urbanisation and democratisation eroded this market mode of consumption. Problems such as insanitary housing and an uneducated workforce combined with competitive party bidding for the votes of a newly-enfranchised working class to lead governments increasingly to assume responsibility for providing social necessities that many people at that time could ill afford to purchase for themselves.<sup>2</sup>

The socialized mode of consumption which developed as a result of this increased government activity rested on the idea that citizens should have a right to a range of basic services financed and/or provided by government, and by 1950, T. H. Marshall had identified this right as one of the core principles of modern citizenship.<sup>3</sup> In most countries, this meant that governments ended up financing or directly providing education, health care, housing, retirement pensions, child support and insurance against periods of unemployment, sickness or other incapacity.

By the 1980s, however, it was clear that this system was in irreversible decline as a result of four factors:

- escalating costs (what Marxists of the time called the 'fiscal crisis of the state'<sup>4</sup>);
- increasing affluence (ordinary people could now afford to buy services which had in earlier times been prohibitively expensive);
- expanded popular aspirations for private ownership (the convenience of car ownership, the autonomy of home ownership, the security of a retirement annuity);

- the sheer momentum of change (for the more people moved from socialized to privatized provision, the more those they left behind wanted to follow them, thus reinforcing the stampede to exit the State system).

All of this led me to suggest that a new ‘privatised’ mode of consumption was emerging in place of the welfare state. This privatised system was not, as has often been argued by critics, a return to nineteenth century arrangements, for having come to occupy such a central place in the life of modern societies during the twentieth century, the democratic State would not and could not abdicate responsibility for the material support of its citizens. Modern political expectations and civic sensibilities would never allow it. The role of government was changing rather than dwindling as it shifted from provider to enabler.<sup>5</sup>

In the emerging privatised system, for example, subsidies and tax incentives are used to allow more people to access private health care, private schooling, home ownership or retirement saving schemes, at the same time as direct provision of the socialised alternatives is gradually wound down. The overall level of government social expenditure might not fall much as a result of this transition, but what does change very visibly is the *form* in which services are produced and consumed. Increasingly, property rights are vested, not in government authorities, but in the final consumers themselves, and the implications of this for personal autonomy, as well as for the role of the State in civil society, are profound.

Although this shift from a socialized to a privatized mode has been in progress for more than twenty years, it is still being fiercely resisted by many social affairs activists and professionals in our universities, voluntary organisations and media. In some cases, this resistance is born of self-interest (for social affairs professionals depend upon the socialized welfare system for their employment, and a shift to a privatized mode threatens to transfer power from them to those who currently consume the services they supply).<sup>6</sup> In other cases, resistance is the result of intellectual laziness or political habit (supporting the welfare state has become totemic; it is a sign of membership of ‘progressive’ political and intellectual circles and a symbol of humanitarianism).<sup>7</sup> But not all defenders of a socialized system are motivated by self-interest or are guilty of laziness; some genuinely believe that the mass welfare state still has a crucial role to play in modern conditions.

The argument that the welfare state is needed takes one of two forms. Some commentators say it is still needed to meet people’s material needs; others argue that it is needed to reinforce the cohesion of society as a whole. I shall try to show in this paper why both arguments are misplaced, and how the transition to a privatized system is consistent both with meeting people’s needs and maintaining a vibrant and functioning society.

### **The politics of poverty**

#### ***Why poverty estimates get exaggerated***

Throughout its history, the welfare state has been linked with a concern to ameliorate or eradicate poverty. It is the existence of poverty that has given the welfare state its

rationale and its popular legitimacy, for without widespread poverty, the case for the generalised welfare state begins to crumble:

- In Britain, the early surveys of poverty by Booth and Rowntree helped shift government thinking and justify early welfare interventions such as non-contributory State old age pensions.
- Half a century later, the so-called ‘rediscovery of poverty’ in the USA (by Harrington), in the UK (by Townsend) and in Australia (by Henderson) again had a massive impact on governments, leading to the ‘War on Poverty’ and the ‘Great Society’ programme in America, to area-based positive discrimination initiatives in Britain, and to the Whitlam government’s health and welfare reforms in Australia.<sup>8</sup>
- Today, nearly half a century after that, the same pattern is being played out, only this time poverty research is being used defensively, to counter attempts by governments to restrain and reform their increasingly antiquated and costly welfare systems.<sup>9</sup>

Poverty statistics are thus intimately bound up with the political battles over social policy. As the welfare state has come under increasing threat, so the social policy establishment has responded with ever-more exaggerated claims about the extent and depth of the poverty problem.

- In Britain, where unemployment is at its lowest for 30 years and the economy has been booming, the Rowntree Foundation claims that more than one-quarter of adults now live in poverty, and that poverty rates are rising. Its latest survey, which claims to have defined and measured poverty ‘scientifically’, also takes seriously the finding that 17 per cent of Britons believe they live below the UN’s definition of absolute poverty.<sup>10</sup>
- Things are not much better in Australia where the key mouthpiece for the welfare lobby, ACOSS, insists that the best measure of poverty is the Henderson poverty line. According to this measure, poverty in Australia affects around 22 per cent of the population – but this estimate rests on a system of indexing which over the course of the 1990s raised the value of the poverty line by twice the rate of inflation!<sup>11</sup>

The reason why welfare lobbyists arm themselves with inflated (and arguably meaningless) estimates like these is that they hope to convince us that the sorts of problems that led nineteenth century governments to get involved in mass welfare provision are still with us, and that a mass welfare solution is therefore still required. No matter how wealthy our societies become, and how much the living standards at the lower end of the income distribution improve year-by-year, the welfare lobby wants us to believe that we shall always need a huge, costly welfare state.

### ***Transitional (lifecycle) hardship***

In reality, of course, even social policy activists and intellectuals know that the world has changed dramatically since the welfare state first emerged. A modest rate of

economic growth (say 3 per cent per annum) sustained over an extended period doubles the real purchasing power of ordinary working people every thirty years or so, and this is precisely what has been happening across the western world. This has meant that the unattainable luxuries of one generation have become commonplace in the next, and the widespread deprivation that brought the welfare state into existence has vanished. With it has gone the rationale for direct government provision on a mass scale.

This is not to say that all poverty and deprivation has disappeared from the developed capitalist countries. Significant proportions of the population may still experience periods of relative hardship as they go through life – as students, when they start a family, when they buy their first home, when they are between jobs, and so on. These people figure prominently in poverty surveys. But in most cases, the periods of relative hardship that they experience do not last for long, and most of those who find the going tough at one time are on a trajectory which soon leads to a more comfortable situation. Throughout the western world, longitudinal income surveys consistently find that between half and two-thirds of those who appear under any given ‘poverty line’ in one year are no longer there just a year or two later.<sup>12</sup>

This means that many of those identified in surveys as ‘relatively poor’ are actually in transition between periods of relative affluence. Over their whole lifetime, they will earn more than enough to get by on; it is just at certain short points in the life cycle that they struggle. The policy implications of this are crucial, for it is clear that income shortfalls in these transitional periods could in principle be covered by savings and investments (e.g. for retirement), loans (e.g. for periods in higher education) or insurance (e.g. to provide an income during periods of sickness or unemployment) funded from earnings during the more affluent periods of people’s lives. Taxpayer-funded income transfers are therefore not necessary to keep most people’s heads above water, even in periods of relative hardship.

### ***Residual poverty and welfare dependency***

This is not true of everybody, however. Although most of us could provide for our consumption needs perfectly adequately without the government doing it for us, not all of us could. Whether as a result of inability to work, lack of opportunity or personal deficiencies of one kind or another, there will always be a small minority of the population incapable of earning enough in the course of a lifetime to sustain themselves. Do we need a welfare state to support them?

Radical libertarians argue we do not. They suggest that needy and deserving cases will be supported informally (e.g. by family and neighbourhood mutual aid, coupled with charitable support and philanthropy), while the lazy and the feckless can make their own decision whether to work or starve. As already noted, however, it is sociologically unrealistic to believe that any government could stand aside and let people go without basic means of subsistence, even if they have brought their fate upon themselves. Like it or not, there will be no return to the nineteenth century market mode of consumption.

This means that some provision will always have to be made for that section of the working-age population who cannot or will not support themselves by working. The key question is, how many people fall into this category?

It is impossible to give an accurate answer to this question, but there are grounds for suggesting that it is probably somewhere between 3 and 5 per cent.

One basis for this estimate is the level of welfare dependency in the past, when the welfare system was more tightly targeted on supporting those incapable of working. In Australia, for example, the proportion of the working-age population receiving social security income support payments in 1965 was just 3.2 per cent – indeed, this figure remained below 5 per cent right through to the Whitlam reforms of the mid-1970s.<sup>13</sup>

A different but complementary indicator of the likely size of the long-term dependent population may be the number of people who currently live in chronic ‘poverty’. Again, an estimate of up to 5 per cent of the population in countries like Britain and Australia seems appropriate:

- In Britain, the Rowntree poverty survey found that only 2.5 per cent of adults (1 in 40) report having experienced long-term poverty and are currently ‘deprived’ on three or more lifestyle indicators;
- In Australia, Rob Bray finds that just 2.2 per cent of the population reports income and spending levels that are lower than 50 per cent of the respective median values in the whole population, the SPRC’s Peter Saunders identifies 5.9 per cent of people as claiming to have insufficient income while also having a ‘deprived’ lifestyle, and Helen Hughes guesses that around 5 per cent of Australians may qualify as ‘poor’ on a relative definition once income from the ‘black economy’ is taken into account.<sup>14</sup>

Of course, the existence of the welfare state may be what keeps rates of chronic, long-term poverty so low. Against this, however, almost all commentators accept that ‘chronic poverty’ is rare in households where somebody has a full-time job. In other words, it is not the welfare state, but paid employment, that keeps people out of chronic poverty. NATSEM’s recent survey for the Smith Family, for example, adopted a very generous poverty definition which produced an estimate of 13 per cent of Australians living below the ‘poverty line’, but even in this study, only 3 per cent of households containing at least one full-time worker were found to be ‘poor’.<sup>15</sup>

Unlike the situation one hundred years ago, therefore, regular, full-time employment has become almost a guarantee against poverty. It is not the welfare system, but the labour market, that offers the best security against poverty in the contemporary period. As the results of the 1996 welfare reform in America have shown, cutting the numbers of people reliant on welfare need not increase poverty – in America, it reduced it (the number of Americans on welfare have been reduced by 60 per cent, yet child poverty is now at its lowest point since 1979).<sup>16</sup>

There will always be some people who for one reason or another are incapable of supporting themselves on a long-term basis. But their numbers are not so large as to require a welfare system on anything like the current scale to support them.

### **The self-financing of welfare benefits**

The most expensive single item to which most people need access during the course of their lives is housing, yet this is the one area of mass consumption where few commentators are any longer prepared to argue the need for a socialized solution. It is obvious why: social housing never took root as a mass tenure in the USA or Australia, where owner occupation has long been the norm and the aspiration, and in Britain, where state rental did become widespread between the 1920s and 1970s, its appeal and relevance has dimmed as its record has tarnished. In the 'Anglo' countries at least, the 'masses' have demonstrated a clear preference to buy rather than to rent from the State, and most of them do just that.<sup>17</sup> Any defence of socialized provision in this area would appear archaic.

In respect of generally cheaper services – health, education and income insurance – it is, however, still commonly argued that government must provide on a mass scale if people are to receive what they need and if 'social justice' is to be served. Yet this is no more true of these heartland areas of the welfare system than it is of housing. The proof of this lies in evidence on the distribution of tax payments and welfare benefits across the population – evidence that shows that most of us are already funding most or all of our welfare benefits.

### ***Simultaneous churning and middle class welfare***

The image that most of us have of the welfare state is of a system that takes from those who can afford to pay and reallocates to those who are poor. The reality, however, is that as welfare spending has grown, so it has had to be funded increasingly by taking money from all sections of society, not just the wealthy or high income earners. This means many people now pay with one hand and receive the money back with the other, and that most beneficiaries end up paying for most or all of what they receive. Indeed, the main reason many welfare recipients appear to need government assistance is that the government has taken so much of their income away in taxation, thereby pushing them into dependency.<sup>18</sup>

James Cox has analysed this process of *simultaneous churning* – the way people pay taxes only to receive the money back straight away in the form of welfare – in the context of New Zealand.<sup>19</sup> He estimates that the top 60 per cent of New Zealand income tax payers receive in cash or in kind 46 per cent of all social expenditure. They get more than their share (71 per cent) of the money spent on public education, plus 55 per cent of the health expenditure, 39 per cent of income-tested benefits, 38 per cent of family assistance and 25 per cent of superannuation assistance. Echoing the public choice analysis of Anthony de Jasay, Cox argues that the government has over time boxed itself into a corner by constantly buying off different sections of the electorate with their own money.<sup>20</sup> The result is that today, many New Zealanders are paying high rates of tax to finance provisions which they could afford to buy for themselves if left to their own devices.

A similar pattern can be found in Australia. The heavy reliance on targeting and means-testing in the Australian income support system means that direct, cash benefits are steeply progressive (while the lowest income quintile receives 27 per cent, the highest receives only 5 per cent), but the distribution of benefits in kind, such as government education and health services, is much flatter and somewhat regressive (the lowest income quintile receives 15 per cent by value as compared with 21 per cent going to the highest quintile).<sup>21</sup> Putting direct and indirect benefits together, Des Moore calculates that the top quintile of income earners receives 14 per cent of total government expenditure on health, education, housing and cash benefits – barely less than the 18 per cent received by the lowest income quintile – and the ABS confirms that the highest gross income quintile receives almost as much on average each week in government payments and services as the lowest (A\$221 against A\$286).<sup>22</sup>

Of course, even if higher earners take almost as much out of the system as lower earners do, it is still true that they pay more in, so the system overall does redistribute money between them. The ABS calculates that the highest quintile in Australia pays an average of A\$661 per week in taxes into the welfare system (leaving this group with a net ‘loss’ on its welfare transactions of A\$439) while the lowest pays an average of just A\$40 (realising a net gain of A\$246). Nevertheless, it is clear that much of the money that goes into the welfare system is effectively returned to the same people.

### *Lifetime churning*

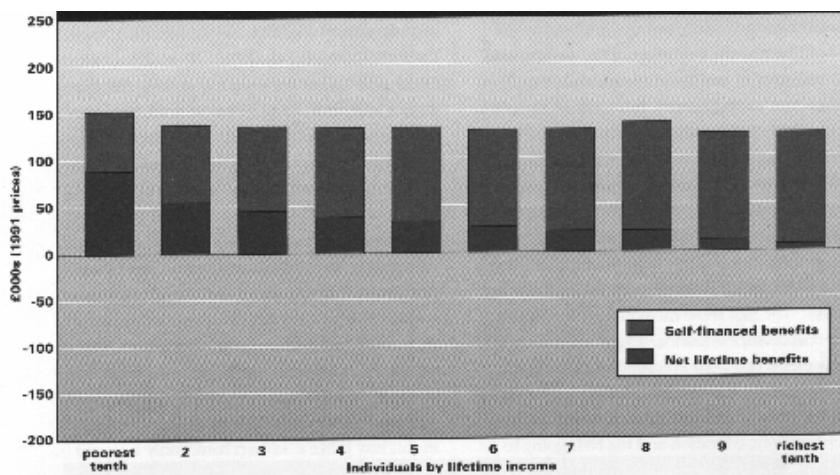
This ‘churning’ of money through the welfare system is even more marked when we look at income flows over an individual’s entire lifetime, rather than at just one point in time. In Britain and Australia, studies have attempted to calculate the total taxes paid, and total value of welfare services received, by different income groups over the course of their entire lives. These simulations divide the population into lifetime income deciles and then calculate how much each decile pays into the welfare system in tax over a full lifetime (assuming current tax rates), and how much it gets back in welfare payments and services (assuming the current system of entitlements). The results show that the modern welfare state operates more as a system of forced saving than as a mechanism of inter-personal income redistribution, for most of us pay in at one point in our lives only to get much of our own money back at another.

This pattern of lifetime churning is particularly marked in social insurance systems, where entitlement to income support is established through personal contributions. In the UK, John Hills and Karen Gardiner find that, while people with higher lifetime earnings pay more tax over a lifetime into the welfare system, the overall allocation of benefits (cash income from social security, plus the value of government health and education services) is remarkably flat. Every income decile receives more-or-less the same (around UKL133,000 at 1991 prices), and on average, UKL98,000 of this is self-financed:

“Nearly three-quarters of what the welfare state does looked at in this way is like a ‘savings bank’; only a quarter is ‘Robin Hood’ redistribution between different people.”<sup>23</sup>

Remarkably, even the 10 per cent of the population that earns least in the course of a lifetime self-finances getting on for half of what it receives, and the next decile up self-finances two-thirds of its receipts.

Figure 1: Self-financed lifetime benefits: UK (Hills and Gardiner)



In Australia, where the government-financed income support system is more tightly targeted, and where eligibility for cash benefits is on the basis of ‘need’ rather than contributions paid, this pattern of lifetime churning is less marked, but it is still strong. Taking 1986 as her base year, Ann Harding calculates the total lifetime value of direct federal taxes (but not indirect taxes) that people pay into the welfare state, and compares this with the total value of cash and education services (but not, initially, health services) that they receive back. She finds that:

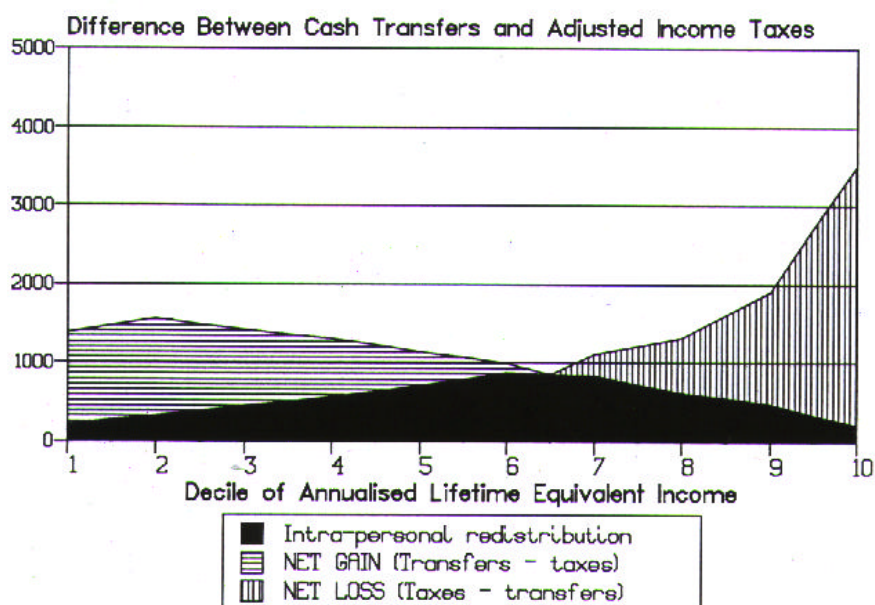
“A significant proportion of income taxes paid during the lifetime are returned to the *same individuals* in the form of cash transfers during some other period of their lifecycle. Over the lifetime there is thus significant ‘churning’ as taxes paid to government at some point in the lifecycle are returned to the same individuals at some other point.”<sup>24</sup>

Harding’s calculations demonstrate that most of the inter-personal redistribution that does occur in the Australian welfare system takes place between men and women, rather than between higher and lower income earners *per se*, and this is mainly because women retire earlier and live longer (i.e. they receive more in age pension payments) as well as benefiting from various family payments.

Taking men and women together, Harding calculates that the bottom income decile receives 21 per cent of its entire lifetime income as welfare cash transfers. This poorest section of the population is therefore remarkably self-reliant, receiving only one-fifth of its lifetime income from government pensions and allowances. Even more surprising is the fact that this same group also pays 12 per cent of its lifetime income to the government in income taxes. Of course, as Harding points out, not all of these taxes go to pay for welfare, and looking only at what she calls ‘adjusted income tax’ (i.e. that portion of their tax devoted to welfare expenditure), she shows (figure 2) that they take much more cash out than they put in. What is most

significant as regards future tax and welfare policy options, though, is that even at the very bottom of the lifetime income distribution, cash benefits account for only one-fifth of lifetime income, and half of this is cancelled out by income tax paid.

Figure 2: Lifetime cash welfare receipts and “adjusted” income tax payments: Australia (Harding)



When we turn from cash benefits to welfare services in kind, Harding finds that lifetime churning is even more marked, and that richer individuals often end up taking more value out of government-funded services than poorer ones do. For example, the highest decile of lifetime income earners receives \$45,000 of taxpayer-funded schooling at 1986 prices, while the lowest decile takes only \$38,600 (were it not for the fact that private schools attract lower levels of public subsidy than government schools, this pattern would be even more regressive). Similarly in health care,<sup>25</sup> although the bottom decile ends up receiving about twice as big a share of government spending on doctors, hospitals and drugs as the highest decile, this is due mainly to the willingness of wealthier groups to pay for private care. Even the bottom decile still pays for \$30,000 of its \$86,000 lifetime health benefits, and on average, Australians end up paying in their taxes for 73 per cent of the government health care they receive.

### ***Taxing the poor***

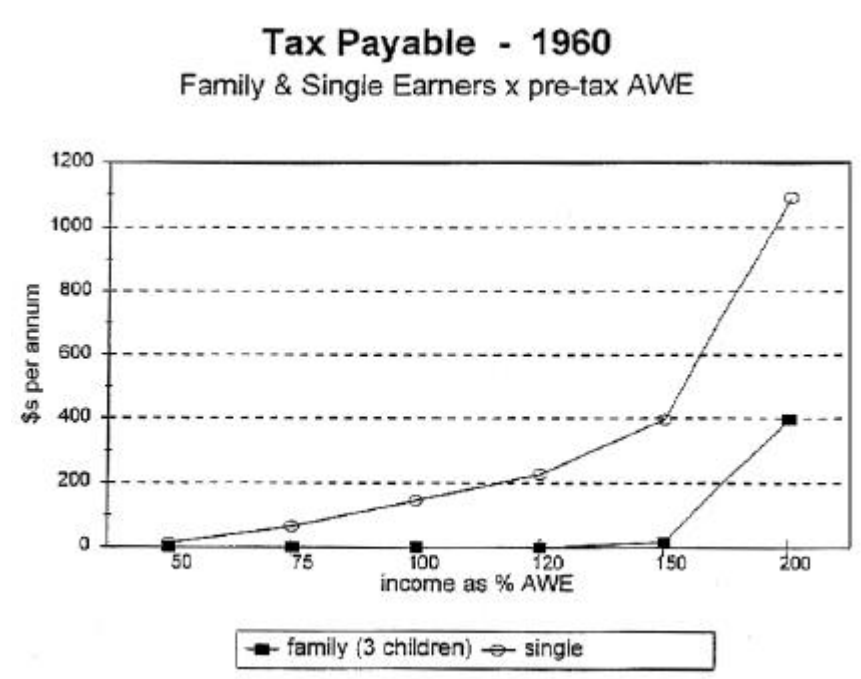
All of this evidence suggests that over a lifetime, most of us end up paying for most of the welfare benefits and services we consume. How could it be otherwise? The welfare state has now grown to such proportions that, inevitably, substantial contributions have to be levied on lower income groups as well as higher ones.

In Australia, the proportion of working-age adults receiving income support has mushroomed from around 3 per cent in the mid-sixties to over 20 per cent today. It is true that some of this increase is accounted for by new and more generous

supplements to low and part-time earners,<sup>26</sup> but that still leaves around 14 per cent of working-age adults dependent on welfare payments for virtually all their income.<sup>27</sup> Inevitably, as the proportion of recipients has risen, so the proportion of payers has dropped. In the mid-1960s, there were 22 workers for every working-age adult dependent on welfare; today there are five. The inevitable result has been an extension of the income tax burden further and further down the income ladder.

At the start of the 1960s, a worker supporting a spouse and three children on Average Weekly Earnings paid no income tax (figure 3)<sup>28</sup>; today, tax cuts in at a threshold of just A\$6,000. But what the government takes away in tax with one hand has then to be replaced by a plethora of welfare payments and services handed back with the other. Deductions levied on low-paid workers have to be replaced with welfare payments of one kind or another. In this way does the modern welfare state come to feed off itself.

Figure 3: Taxation levels, Australia, 1960 (Sullivan)



The latest proposal for coming to grips with this problem is that tax credits could be given to low-income working households to boost their net pay and improve the incentive to move from welfare to work.<sup>29</sup> But tax credits threaten to plunge us even deeper down the hole we are digging, for here is one more welfare payment to add to all the rest. Any new tax credit system would be expensive (so other workers will have to pay even more tax to fund it); it would be wide open to fraud (for there is an incentive to reduce 'on-the-books' earnings so as to maximise the value of the credit); and, most important of all, it would lock hundreds of thousands more people into partial dependency on what is essentially a welfare cash handout while eroding the financial incentives to improve their own earnings.<sup>30</sup>

The answer to the problem of high taxation and high welfare dependency is not to introduce another costly welfare payment. It is to reduce the taxes that are levied on lower income workers.

### ***Forced saving***

We have seen that the key role of the welfare system for most citizens today is (to use the terminology of Hills and Gardiner) as a ‘piggy bank’. By taking taxes away from us during the more prosperous periods of our lives and returning the money to us during the leaner years, the government is ensuring that we save enough to cover our lifetime needs. However, we exert precious little control over this process and the administrative cost of all this churning is very high.

It is important, of course, that individuals should ‘smooth out’ their lifetime income flows, but using the welfare state to achieve this is a cumbersome solution to what is really a very simple problem. As developments around the world have been demonstrating, the same outcome can be achieved more efficiently and equitably by developing instruments like Personal Savings or Investment Accounts which allow people to accumulate funds in their own personalised accounts and to play an active role in how they are managed.<sup>31</sup> The welfare state is a bureaucratic, costly, non-responsive and increasingly anachronistic way of forcing us to save. There are better ways of achieving the same outcome.

### **Policy options**

Let us summarise some of the policy possibilities that come out of this analysis.

- **Support for a needy minority:** We have seen that the ‘mass’ problem of meeting people’s basic consumption needs which brought the welfare state into existence at the start of the twentieth century has now dwindled to become a minority, targetable problem. Despite the current size of our welfare rolls, probably no more than 5 per cent of working-age adults should need long-term government aid and support, and they are people who for one reason or another cannot work. Poverty surveys exaggerate the size of the problem by including transitional periods of low income with chronic long-term hardship. The latter is today almost entirely caused by lack of full-time paid employment, and the solution to it lies not in expanding welfare, but in getting more people who currently rely on welfare into the labour force. This in turn means we have to ensure there are jobs for them to do – particularly lower-skilled, lower-paid jobs. The supply of lower-skilled jobs can only be expanded by further *labour market reform* (in particular, changing the award system and reforming the unfair dismissal laws<sup>32</sup>).
- **Reducing the number of welfare claimants:** Although it sometimes seems to be forgotten, expanding welfare rolls indicate social policy failure, not success. Reducing the number of people depending on welfare will require *tighter eligibility rules*. The number of Disability Pensioners, for example, has almost trebled in 30 years to 6 per cent of the working age population, suggesting that ‘disability’ needs redefining. Numbers of single parent claimants have also escalated, and it would be in line with community expectations to reduce this number by expecting claimants to re-enter the labour force once their dependent children start school<sup>33</sup>). Welfare rolls can also be cut by setting *time-limits* on temporary assistance for unemployed claimants. Half of all

unemployed people find a new job within 8 weeks, but one-third are unemployed for a year or more. American experience suggests that time limits, coupled with intensive one-to-one counselling, can dramatically reduce long-term welfare dependency rates, although there is also a strong case for government to be the job-provider of last resort (i.e. 'work for dole') for those who exceed their welfare time limits.<sup>34</sup>

- Ending middle class welfare: Welfare services, such as public education and health care, benefit high and middle income earners almost as much (and sometimes more than) low earners. Yet many recipients do not need this help from government. Even under current arrangements, most 'middle income households' could afford to purchase their health care, education and retirement annuities from outside the State system, and many more could do so if government switched its funding from paying service producers to supporting service consumers. This could be achieved by phasing out direct provisioning in favour of subsidised purchases (e.g. through *tax allowances or vouchers* to offset schooling costs).<sup>35</sup>
- Overcoming simultaneous churning: The fundamental problem of Australia's means-tested, non-contributory income support system is that it inevitably creates 'welfare traps' and huge disincentive effects when recipients seek to improve their situation. Proposed tax credits for working households would exacerbate rather than resolve this problem. The solution lies in an *increase in personal tax thresholds* designed to get us back to a position where low-paid workers pay no income tax and have no need of welfare top-ups. The present system of taking money with one hand and giving it back with the other has to be changed if high EMTRs are to be avoided. We currently start taxing workers at A\$6000 yet this is well below the income required for self-reliance (the welfare floor for a single person is more than A\$12,000, and the federal minimum wage is around A\$22,000).
- Saving instead of lifetime churning: A large part of welfare expenditure involves intra- rather than inter-personal transfers as money is taken away at one point in the life cycle and returned at another. A more sensible and less costly alternative which is consistent with the principles of the 'enabling state' would be to require or encourage wage earners to save and invest in their own personal accounts (which might be supplemented where necessary by means of 'matched savings', as in the UK and various experimental US schemes). The Australian compulsory superannuation scheme is a first step down this road, although this system needs reforming as well as expanding. In Singapore, personal accounts are now used to fund house purchase, education and new business formation as well as retirement, and in Chile, personal funds are recently been extended to provide unemployment insurance as well as retirement annuities.<sup>36</sup>

Reviewing this list, we can begin to see how the transition from a twentieth century socialised mode of consumption to a twenty-first century privatised mode involves linked innovations across five areas of public policy: labour market reform (so people who are capable of working can find jobs); reform of the income support system (to reverse the forty-year trend to increasing dependency); change in the funding of

universal services (to enable consumers to purchase the services of their choice); tax reform (so that even low-paid workers retain enough of their own earnings not to require government top-ups); and savings reform (so that workers build up their own resources to fund their retirement and out-of-work insurance needs in place of the welfare system's lifetime churning of people's incomes).

### **The sociological/cultural arguments for state-controlled welfare**

We no longer need the welfare state to ensure that people's basic consumption needs are met. There is, however, a long-standing assertion in the sociological literature which claims that this is not, or should not be seen as, the key role for the modern state welfare system to discharge. According to this argument, the welfare state is still needed sociologically, even if not economically, for its role is to bind our society together.

The argument takes two forms. First, there is the specific claim that the minority of the population that still needs help will be abandoned unless everybody else is forced into participating in a common, state-organised, welfare system. Secondly, there is the more general claim that market relations undermine social cohesion and solidarity and that the welfare state is needed to bring us all back together again. Both arguments are repeatedly heard, but once we take the trouble to analyse what they are saying, neither is convincing.

#### ***Middle class welfare as an insurance for the poor***

The first argument was outlined by Julian Le Grand twenty years ago<sup>37</sup> and has recently been restated in Australia by the SPRC's Peter Saunders. He accepts the 'arithmetic' argument that many of us no longer need the welfare state to provide for us, but he rejects as 'naïve' the conclusion that our society could therefore get by without it:

“Neo-liberal critics of ‘income churning’ have argued that the net distributional impact could be achieved with a far smaller state sector... This is arithmetically accurate but politically naïve because it ignores the role of broadly-based programs in underpinning the support of the middle classes, without which the welfare state would founder politically...Middle class welfare is the lifeblood of the welfare state”<sup>38</sup>

What is being argued here is that people have to be coerced into paying for a system they do not need to prevent the system from collapsing. There are a number of obvious points to make in response to this logic:

- The argument is tautological. It makes no sense to defend a universal, comprehensive system on the grounds that it would collapse if it were not universal and comprehensive. The system has here become its own reason for existence. It is illogical to worry about how to keep people on board a system that has outlived its usefulness.

- The argument is ethically dubious. Essentially it endorses the idea that politicians should bribe electors with their own taxes. The argument rests on an assumption that people will only be willing to pay money to help others in need if they think that they will get something too. But this was never the rationale for a universal welfare system. If people have to be bribed to support it, then we are better off finding an alternative.
- The argument is historically blind. Before governments took over the responsibility to provide for people's consumption needs, ordinary people often organised such provisions for themselves. Thriving mutual aid arrangements emerged in Australia, Britain and the UK around the late nineteenth century, but these were undermined by the imposition of compulsory, tax-funded State systems. Historically, therefore, it makes little sense to say that universal systems are needed to protect lower income groups, for it was the emergence of universal systems that stopped lower income groups from organising their own arrangements in the first place.<sup>39</sup>
- The argument is also unnecessarily pessimistic. Before the welfare state evolved, more privileged sectors of society often recognised a social responsibility to support those who could not care for themselves, and even today, the State welfare system is complemented by hundreds of voluntary agencies dedicated to looking after those in need. Furthermore, public opinion surveys suggest that there is strong public support for policies designed to help those who cannot be expected to help themselves.<sup>40</sup> All this suggests that higher income groups (and corporations) do not need to be forced or tricked into supporting fellow citizens who are needy and deserving. They have done it in the past, and despite the existence of a State system, many still do it to this day.

### *The welfare state holds society together*

The broader sociological case for the welfare state is that society would fray and fragment without it. This is often taken as a self-evident truth by those who seek to defend and expand the socialized system. They think that an extensive welfare state is all that stands between us and an individualistic, atomised, fragmented and anomic society polarised between a privileged class barricaded behind 'gated communities' and a dispossessed, alienated and increasingly desperate underclass. The welfare state, in other words, is a *civilising* institution at the heart of contemporary capitalism, a source of civic altruism in a sea of competitive individualism.

This argument was implicit in Marshall's suggestion that welfare rights are an integral component of what it is to be a citizen, and it has been taken for-granted ever since by social policy intellectuals and activists in demands that government increase welfare spending to head off impending social break-down.<sup>41</sup> But the argument is almost totally groundless. I have discussed the issues that it raises in more detail elsewhere<sup>42</sup>, but essentially:

- It misunderstands the sources of social cohesion. As sociologists like Peter Berger have long argued, and as 'third way' revisionists like Mark Latham and Peter Botsman also now accept, cohesion develops from the bottom-up, not

the top-down.<sup>43</sup> A sense of common identity and mutual empathy develops, not from state bureaucracies administering largesse from on high, but out of the ‘little platoons’ of families and neighbourhood associations coming together to solve common problems. To the extent that the welfare state has taken over responsibilities from these smaller agencies of civil society and left them with nothing to do for themselves, it is more likely to have eroded social cohesion than to have contributed to it.

- It misunderstands the social character of market-based relations. Market transactions do not produce social disaggregation – quite the reverse, market relationships and private property rights create the conditions in which an active civil society can flourish. As Michael Novak suggests, “Markets draw individuals out of isolation and into reasoned, civil, voluntary interchange with their fellows.”<sup>44</sup> Classic sociological indicators of social malaise (divorce, crime, drug abuse, mental illness, etc) were all much lower during the market mode of consumption in the late nineteenth century and increased as the welfare state expanded. Clearly, then, there is no inherent link between market-based social life and social atomism. Indeed, the capitalist market system has historically co-existed with both individualistic and communalistic cultures.<sup>45</sup>
- It misrepresents the lived reality (as against the ideology) of welfare state relations. The welfare exchange between donors and recipients is not one that builds trust and mutual recognition, and it is more likely to fragment than to unify. The experience of receiving aid from government welfare agencies is widely recognised as being alienative, stigmatising and disempowering. No matter how much state agencies try to change this (e.g. by redefining recipients from ‘claimants’, through ‘clients’ to ‘customers’), the relationship remains the same, for the welfare system is inherently impersonal and bureaucratic. Similarly, the experience of paying into the system does not generally foster values of altruism, but rather creates suspicion of one’s fellow citizens. The rhetoric of ‘bludgers’, which social policy intellectuals like to explain away as the product of media scare campaigns, is better understood as an expression of frustration and anger by people of modest means who look around their own immediate neighbourhoods and see others taking advantage. The welfare relationship, then, is not one that generates cohesion and solidarity. Far from binding us all together, the lived reality of the welfare state is that it ferments distrust, encourages dishonesty, undermines social responsibility and reinforces selfishness.

## **Conclusion**

The twentieth century welfare state was a response to a set of problems and concerns that are no longer with us. We should, however, beware the functionalist fallacy that assumes that social institutions develop when the need for them arises and disappear when their social purpose has lapsed. There is nothing ‘inevitable’ about the transition from a socialised to a privatised mode of consumption. Although the welfare state has outlived its usefulness, and in some ways is now doing more harm than good, there are powerful interests aligned behind its retention, and the mythology

of the welfare state continues to exert a strong hold on popular sentiment. Just because we no longer need the system does not mean it is about to disappear.

In this paper I have outlined some of the directions in which policy could move in order to take us beyond the twentieth century welfare state model. Some of these ideas are already on the agenda (labour market reform; reductions in size of the welfare rolls); others may appear more contentious or even unrealistic (a zero-tax policy for lower income earners<sup>46</sup>; tax allowances or vouchers to replace directly-provided government services; personal savings schemes to replace government retirement, unemployment and sickness benefits). The key point about all of these proposals and initiatives, however, is that they represent a move forward from the existing system, not (as critics so often claim) a move back to the previous one. Government in the twenty-first century still has a key role to play, but it is increasingly as facilitator rather than as direct provider. In the emerging privatised mode of consumption, most of us will assume responsibility for most aspects of our lives, and the role of government will be to underpin and extend this exercise of personal capacity rather than curtailing and restricting it.

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<sup>1</sup> P. Saunders, *Social Theory and the Urban Question* 2<sup>nd</sup> edition (London, Hutchinson, 1986), chapter 8.

<sup>2</sup> Although many working class people could and did make provision for themselves even then – see D. Green, *Mutual Aid or Welfare State* (Sydney, Allen & Unwin 1984)

<sup>3</sup> T. H. Marshall, 'Citizenship and social class' in his *Citizenship and social class and other essays* Cambridge University Press, 1950

<sup>4</sup> J. O'Connor, *The Fiscal Crisis of the State* (St Martins Press, New York, 1973)

<sup>5</sup> This idea of the state as enabler has more recently been developed as part of a "Third Way" political agenda – see, for example, P. Botsman and M. Latham, eds., *The Enabling State* (Pluto Press, Annandale, 2001)

<sup>6</sup> As Michael Duffy puts it: "If the sheep can look after themselves, they will not need shepherds" (*The Australian* 7 October 2002)

<sup>7</sup> There is an unthinking tendency still to equate socialist ideas with personal morality. As David Green notes: "For decades, capitalism has been characterized as callous and uncaring and socialism as humanitarian. The result is that it takes quite an effort for intellectuals to break with socialism because, at first, the choice seems to be as stark as that between good and evil" (*Equalizing People* London, IEA, 1990, p.3).

<sup>8</sup> According to Michael Jones (*The Australian Welfare State*, Allen & Unwin, 4<sup>th</sup> edn, 1996, p.27), "In 1971, Australia had a minimal welfare state." Henderson's crucially influential survey of poverty in Melbourne was published in 1970.

<sup>9</sup> I have discussed some of the claims currently being made by the poverty lobby in Australia in P. Saunders and K. Tsumori, *Poverty in Australia: Beyond the Rhetoric* (CIS 2002). It is worth noting in passing that there is a logical contradiction in trying to defend the welfare state by claiming that poverty is still widespread, for if high levels of welfare spending were the solution to poverty, the problems should have disappeared by now. It is its own failure to overcome poverty that enables defenders of the welfare system to argue for its retention!

<sup>10</sup> See D. Gordon, 'Measuring absolute and overall poverty' In D. Gordon and P. Townsend, *Breadline Europe* (Polity Press, Bristol, 2000); David Gordon, *Poverty and social exclusion in Britain* (York,

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Joseph Rowntree Foundation 2000). The estimate of 26% of the population in poverty is based on the number of respondents who claimed to be unable to afford at least two from a list of 29 'socially necessary' items. The 17 per cent of Britons who think they live below the UN's absolute poverty line apparently believe that they suffer from life-threatening conditions such as unclean drinking water, lack of sanitation, shortage of food and absence of health and education services.

<sup>11</sup> The Henderson line is regularly updated by the Melbourne Institute and latest poverty estimates are published on its website ([www.melbourneinstitute.com/](http://www.melbourneinstitute.com/)). For a discussion of issues regarding the method of updating, see H. Greenwell, R. Lloyd and A. Harding, 'An introduction to poverty measurement issues' (NATSEM *Discussion Paper* No. 55, Canberra, 2001).

<sup>12</sup> C. Whelan, R. Layte, M. Maitre, B. Nolan. 'Persistent income poverty and deprivation in the European Union' *European Panel Analysis Group Working Paper* No 17 (Dublin, Economic and Social Research Institute, 2001)

<sup>13</sup> Department of Family & Community Services, *Trends in Pension and Benefit Receipt* (Research FaCS Sheet No. 2, 1999); P. Whiteford and G. Angement, *The Australian System of Social Protection: An Overview* FaCS Occasional Paper No. 6, 2<sup>nd</sup> edition, 2001.

<sup>14</sup> R. Bray, 'Poverty lines and living standards' Paper to FaCS seminar on 'Hardship in Australia' (Sydney, 2 September 2002); P. Saunders, *The Ends and Means of Welfare* (Cambridge UP, Port Melbourne, 2002); H. Hughes 'The politics of envy' *Policy* vol.17, 2001

<sup>15</sup> A. Harding, R. Lloyd, H. Greenwell, *Financial disadvantage in Australia 1990-2000* (Smith Family, Sydney, 2000)

<sup>16</sup> R. Haskins, 'The poor go to work' *The American Enterprise* (April/May 2002, 41); also 'The welfare watershed', *Wall Street Journal* 13 May 2002

<sup>17</sup> I have analysed the desire to own in *A Nation of Home Owners* (Unwin Hyman 1990). This does seem to be particularly marked in the 'Anglo' cultures, or what Esping Anderson calls the 'liberal' welfare state regimes.

<sup>18</sup> See Lucy Sullivan *Taxing the Family* (CIS 2001). We are now in the absurd position where taxation begins at a level of income well below subsistence level, and individuals and families then have to be given support to bring them back up to this level. This, of course, is why modern governments are confronted with a seemingly insoluble problem of 'poverty traps' and 'welfare traps': if those on low incomes paid no tax, they would not need so much welfare support, and they would not then be penalized by high effective marginal tax rates when they start to earn more.

<sup>19</sup> J. Cox *Middle Class Welfare* (Wellington, NZ Business Round Table, 2001)

<sup>20</sup> A. de Jasay, *The State*, chapter 4

<sup>21</sup> ABS, *Government benefits, taxes and household income 1998-99* (ABS Catalog 6537.0, 2001)

<sup>22</sup> Des Moore, 'Election on jobs a good wager' *Australian Financial Review* 22 January 2003; ABS, *op cit*

<sup>23</sup> R. Hills and K. Gardiner, *The Future of Welfare* (York, Joseph Rowntree Foundation, 1997), p.19

<sup>24</sup> A. Harding, *Lifetime Income Distribution and Redistribution* (North-Holland, Amsterdam, 1993), p.168, emphasis in original. See also Harding, 'Lifetime versus annual tax-transfer incidence', *The Economic Record* (vol. 69, no.205, June 1993, 179-91)

<sup>25</sup> Health is modeled in a later paper – A. Harding, R. Percival, D. Schofield and A. Walker, 'The lifetime distributional impact of government health outlays' NATSEM *Discussion Paper* number 47 (February 2000)

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<sup>26</sup> P. Henman 'Deconstructing welfare dependency' *Radical Statistics* 79/80. 2002, 7-17

<sup>27</sup> In 1999, ABS estimated the proportion of working age adults reliant on income support for at least 90 per cent of their income at 15% (ABS *Research FaCS Sheet* Number 3, 1999; also K. Bond and P. Whiteford, 'Income support payments in Australia' In ABS *Yearbook Australia 2000* Catalog 1301.0, 185-90, AusInfo, Canberra)

<sup>28</sup> Lucy Sullivan, *Taxing the Family*, op cit

<sup>29</sup> This idea was floated in Australia in a letter to the Prime Minister from five leading economists, and has also been taken up by the Business Council of Australia. See P. Dawkins, 'A plan to cut unemployment in Australia' (*Melbourne Institute Quarterly Bulletin* vol.1, 1999); also the papers and debates in Business Council of Australia, *Rebuilding the safety net* (Melbourne 2000). Both major parties are now giving the proposal serious consideration

<sup>30</sup> See the analysis of the UK's new tax credit system by Frank Field (*Welfare Titans*, Civitas, London, 2002); also K. Tsumori, 'Some reflections on the earnings credit' (Paper to AIFS conference, Melbourne, February 2003).

<sup>31</sup> I have summarised some of these initiatives in P. Saunders, 'What future for welfare' (Free Market Foundation, Sandton, SA, *Occasional Paper* N.11, 2002).

<sup>32</sup> K. Tsumori, 'Poor Laws I: The unfair dismissal laws and long-term unemployment' (*CIS Issue Analysis* No.26, 2002); K. Tsumori, 'Poor Laws II: The minimum wage and unemployment' (*CIS Issue Analysis* No.28, 2002)

<sup>33</sup> The number of disability pensioners increased from 229,200 in 1980 to 602,300 in 2000 (ABS, *Australian Social trends 2002: Income and Expenditure*). It has been shown that this increase has little to do with actual disability rates (see E. Healy, 'Disability of disadvantage', *People and Place* vol.10, 2002, 68-83). Research on public attitudes conducted by SPRC finds that over half the population thinks it appropriate that sole parents should look for a part-time job once their youngest child starts school, and nearly half say sole parents should be expected to work full-time once their children reach 11 years of age (T. Eardley, P. Saunders and C. Evans, 'Community attitudes towards unemployment, activity testing and mutual obligation', *SPRC Discussion Paper* N. 107, May 2000).

<sup>34</sup> On Australian unemployment figures, see ABS, *Australian Social Trends 2002: Work*. On the case for government as employer of last resort, see D. Ellwood, *Poor Support: Poverty in the American Family* (New York, Basic Books, 1988); and D. Ellwood, 'The US vision of work-based reform' In T. Eardley and B. Bradbury (eds), *Competing Visions* (SRC Report 1/02, April 2002)

<sup>35</sup> See, for example, J. Buckingham (*Families, Freedom and Education*, CIS, 2001) on how schooling could better be funded by a system of tax allowances.

<sup>36</sup> On American experience with personal savings initiatives, see M. Sherraden, 'From research to policy: Lessons from Individual development Accounts' *Journal of Consumer Affairs* vol.34 2000, 159-81, and M. Schreiner et al, 'Savings and asset accumulation in IDAs, Centre for Social Development, Washington, February 2001. On recent UK initiatives, see HM Treasury, *Saving and assets for all*, London, April 2001. On recent developments in Chile, where individual investment accounts to cover retirement have now been extended to provide personal unemployment insurance as well, see W. Conerly, 'Chile leads the way with Individual Unemployment Accounts' *Brief Analysis* No.424, National Centre for Policy Analysis, Dallas, November 2002

<sup>37</sup> R. Goodin and J. LeGrand *Not only the poor: The middle classes and the welfare state* (London, Allen and Unwin, 1987)

<sup>38</sup> Saunders, *Ends and Means* p. 59

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<sup>39</sup> In addition to David Green's work on Australia, see also: D. Green *Reinventing Civil Society* (London, IEA, 1993) and D. Beito *From Mutual Aid to the Welfare State* (Chapel Hill, University of North Carolina Press, 2000)

<sup>40</sup> Eardley, Saunders and Evans, *op cit*.

<sup>41</sup> The latest example is from ACOSS, quoted in *The Australian*, 30 January 2003: "Mr McCallum said it was up to the federal and state governments to try to redress the social divide. "We forget that good economic growth does not impact society equally," he said. "The consequences are that society pays one way or the other. We pay for it through social control or we pay for it through good social policies... "

<sup>42</sup> See P. Saunders, *Capitalism: A social audit* (Buckingham, Open University Press, 1995, chapter 4); P. Saunders 'Citizenship in a liberal society', in B. Turner, *Citizenship and Social Theory* (London, Sage, 1993); Saunders and Tsumori, chapter 4

<sup>43</sup> P. Berger and R. Neuhaus, *To empower people* (Washington, American Enterprise Institute, 1987); P. Botsman and M. Latham, *The Enabling State*.

<sup>44</sup> M. Novak, *Morality, capitalism and democracy* London, IEA, 1990, 13

<sup>45</sup> N. Abercrombie et al, *Sovereign Individuals of Capitalism* (Allen & Unwin 1986)

<sup>46</sup> This is not as 'unrealistic' as it might seem – as a result of the latest tax cuts in America, an American family of two adults and two children with an annual income of US\$40,000 (A\$67,800) will now pay just US\$45 (A\$76) a year in federal income tax (*Daily Telegraph*, Sydney, 30 January 2003). An income of this size in Australia will get you into the top tax bracket!